

**Republic of Estonia**

**ACTION PLAN FOR GROWTH AND  
JOBS  
2005–2007**

**For implementation of the Lisbon Strategy**

**Tallinn  
2005**

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## INTRODUCTION

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The changes taking place in the European economy and society presuppose a greater commitment to economic competitiveness in order to preserve the European welfare model. For this end, the European Commission updated its proposals at the beginning of 2005, in order to promote economic growth and creation of jobs through a directed partnership between the European Union and its member states.

The updated Lisbon Strategy, or the so-called Growth and Jobs strategy, was approved by the European Council in spring 2005. The Heads of Governments agreed that each Member State would develop an action plan directed at the promotion of economic growth and creation of jobs. It was also decided that, in the development of the action plan, the Member States would proceed from jointly agreed integrated guidelines and recommendations of the European Commission regarding the activities necessary for increasing the competitiveness of the member states.

### **The goal of the Action Plan and connection with other strategic documents**

The Estonian Action Plan for Growth and Jobs is a program document of the Government of the Republic that summarizes the primary goals for increasing Estonian competitiveness during 2005–2007. In the preparations of the plan, integrated guidelines of the European Union – macroeconomy, microeconomy, and employment (see appendix 1) – have been taken into account, as well as the recommendations of the European Commission regarding the activities necessary for the increasing the competitiveness of Estonia.

The Action Plan for Growth and Jobs is based on the sectoral strategies and development plans. From these, the Action Plan highlights and combines measures directly supporting the increase of Estonia's competitiveness. The Action Plan is the basis for the preparation of annual work plans for the government and ministries, which is why the Plan does not include detailed activities. These are determined when the government's annual work plan is compiled, taking account the objectives of the Action Plan.

Action Plan includes the measures and general activities necessary for achieving the objectives. In order to keep track on the developments, monitoring indicators have been defined for measures. These indicators are not included in the plan as goals defined by the government, but as references, to make it possible to forecast the developments in the field of activity. The indicators are to a great extent based on the structural indicators agreed upon by the Member States and the indicators used in various international research (OECD, World Bank) making comparative benchmark results available. Nevertheless, as structural indicators often do not give detailed overview about the outcome of specific measures within the perspective of a few years, specific indicators are included that allow exact monitoring of Estonia's progress and the effectiveness of the measures.<sup>1</sup>

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<sup>1</sup> On the basis of the indicators included in current year's plan, complex system of indicators will be worked out, which can be used primarily to evaluate the effectiveness of the measures to increase competitiveness, and for the annual competitiveness evaluation.

For two indicators – expenditures for research and development as a proportion from GDP and general employment rate – the government has set specific goals for 2008, 2010, and 2014.

The planned measures and activities are covered by state budgetary resources and are in accordance with state budgetary strategy. The goals and measures presented in the Action Plan are taken as a basis for the planning of European Union structural funds for the next programming period of 2007–2013 by the Ministry of Finance. Measures and activities are as well in concordance with the Convergence Programme.

In the preparation of the Action Plan, the schedule and principles of the European Union decision-making process have been taken into account. This means that the Member State will annually evaluate the success of the fulfilment of the plan, will submit a report on the fulfilment of the Action Plan to the European Commission, and will adjust the set goals and measures according to the recommendations of the European Commission and national priorities in the case of need. Therefore, the goals, activities, and indicators included in the plan, may be amended and supplemented in following years.

### **Organisation of the preparations of the Action Plan**

The Action Plan has been prepared in dialogue with the European Commission. The Commission introduced its expectations related to the Action Plan at a meeting in Tallinn on 15 June 2005, to the representatives of ministries related to the implementation of the Lisbon Strategy, to the Members of Parliament, and representatives of social partners.

As a result of the meeting, the Commission outlined the most important sectoral problems for 2005–2008, which served as a basis for the preparation of the structure of the Action Plan:

- o low employment level, structural unemployment, skills of the labour force and need for lifelong learning – high rate of long-term unemployment, increased unemployment among youth and women, high school drop-out rate, poor vocational education, and poor training of labour;
- o Research and development activities and innovation – limited cooperation between scientists and entrepreneurs, lack of skilled labour, low level of private sector investments to research and development, fragmented higher education system.

The preparation of the Action Plan was coordinated by the State Chancellery. A working group was established for the preparation of the Action Plan, which in addition to the representatives of the ministries related to the implementation of the objectives, included the representatives of social partners (see appendix 3). In addition to social partners, experts from universities and scientific institutions were involved.

Three sector specific sub-working groups were established, for which:

- o The Ministry of Finance was the coordinator and general supervisor for the macroeconomic guidelines,
- o The Ministry of Economic Affairs and Communications was the coordinator and general supervisor for the microeconomic guidelines, and
- o The Ministry of Social Affairs was the coordinator and general supervisor for employment policy.

All the members of the working groups have had the possibility to make contributions to the preparation of the Action Plan at meetings of the working group or by submitting electronic and/or written proposals. In addition to the working group and sub-working groups, the goals and measures of the Action Plan (expenditures for research and development as a proportion

from GDP and the establishment of an Estonian Development Fund<sup>2</sup>) were discussed at the meeting of the Research and Development Council on 14<sup>th</sup> of September. Government launched a public debate through making the Action Plan available in the internet portal “Today I Decide” (Täna Otsustan Mina). It was possible to forward comments on the Action Plan during the period of 27<sup>th</sup> September – 7<sup>th</sup> October. Result of the debates and proposals of relevant ministries and social partners were considered and, if possible, taken into account during official coordination round held after the Plan was agreed in principle by the Government of the Republic on 22<sup>nd</sup> of September.

Deliberations in the Parliamentary Committees were organized after the Government introduced the Plan to the Parliament on 29<sup>th</sup> of September. The Action Plan was discussed by the Finance Committee, Economic Affairs Committee, Cultural Affairs Committee, Social Affairs Committee and Environment Committee. The Action Plan was approved by the Government of the Republic on 13<sup>th</sup> October and by the EU Affairs Committee of the Riigikogu on 14<sup>th</sup> of October.

### **Implementation of the Action Plan**

The Government has assigned the Secretary of State to coordinate the monitoring and implementation of the Action Plan, and conduct evaluations and reporting. Inter-ministerial Competitiveness Working Group formed for developing the Action Plan continues its work under renewed capacity, dealing with implementing and updating the plan as well as reporting and evaluating outcomes of the process. The Secretary of State has a responsibility to present regular implementation reports to the Government and he has to guarantee, that the Government’s Annual Action Plan and working plans of the ministries are consistent with the Action Plan for Growth and Jobs.

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<sup>2</sup> Also referred to as Venture Capital Fund

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## PART 1: MACROECONOMIC ENVIRONMENT

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***General macroeconomic development.*** Economic growth in Estonia for 2004 reached 7.8%, which has been highest during the last years. The beginning of 2005 was even more successful – economic growth reached 8.7%. The average economic growth during the last 10 years has been 6.1%; in the EU, only Ireland has achieved more – 7.8%. Since the average economic growth for the EU25 during the same period has been 2.3%, the Estonian GDP per capita, taking into account the purchasing power parity, has increased from initial one-third to one-half of the EU average. If the present development continues, by 2010, we will reach about 62–63% of the EU average.

The economic growth has been supported by continuous rapid growth of productivity, which has been in compliance with the wage growth. This tendency has guaranteed the preservation and even rise of competitiveness of Estonian enterprises in foreign markets in the circumstances where economic growth of our main trading partners has been low. The economic growth in recent years has mostly based on exports – the real growth in exports of goods and services has increased to 16% in 2004 and to 17.4% in the first half of 2005. The growth of imports was slower than the growth of exports. The increase in the volume of exports was caused by an increase in external demand on the one hand (increase in the economic growth of trading partners), and on the other hand, by an increase in the competitiveness of Estonian goods (measured as a percentage of EU24 imports). An increase in the growth of service exports was caused by an upturn in the tourism and transit sector. An important contribution to economic growth was caused by domestic demand, although the expansion rate of it slowed down in comparison to 2003. The growth of investments has also slowed down, due to decrease in private consumption and completion of large one-time projects. The increase in domestic demand was supported by the increased growth of the final consumption of government sector. The fastest growth is in the fields of manufacturing industry, construction, hotels and restaurants, and financial intermediation.

The rapid growth of domestic demand in previous years caused increase in the current account deficit. It is important to note that the reason for the deficit is not the decrease of Estonian competitiveness in external markets<sup>3</sup>. The reasons for the current account deficit have been the imports of capital goods, the inflow of foreign direct investments (FDI) and the increased deficit of the revenue balance due to profitability of FDI. However, the latter does not indicate an actual outflow of capital, but it is mostly reinvested profits that are shown in the balance of payments as double entries, i.e. as outflow of revenues in the current account and inflow of FDI in the financial account. In 2005, the growth in exports has contributed to a decrease in the current account deficit.

The increase in inflation to 3.0% in 2004 was primarily caused by changes in the tax policy and foreign trade policy resulting from the EU accession, while the rise in administratively non-regulated prices remained moderate. Additional price pressure was caused by increase in oil prices, the effects of which have increased even more due to the strengthening of the US dollar

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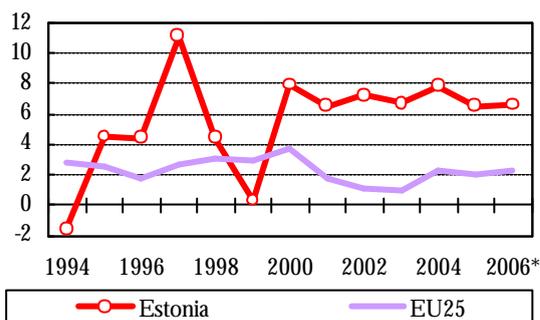
<sup>3</sup> See also for instance, Concluding Statement of the IMF 2005 Article IV Consultation Mission – IMF July 22, 2005 (<http://www.eestipank.info/pub/et/majandus/IMF/20050722.pdf?objId=652670>) and *Estonia's external account deficit: a sign of success or a problem?* – ECFIN Country Focus Volume 2, Issue 13, 7.07.2005 ([http://europa.eu.int/comm/economy\\_finance/publications/country\\_focus/2005/countryfocus13\\_en.htm](http://europa.eu.int/comm/economy_finance/publications/country_focus/2005/countryfocus13_en.htm)).

in the last few months. The relative importance of motor fuel in Estonia's consumer basket is greater than the EU average – 6.4% or 3.8% respectively. In addition to the increase in fuel prices, the acceleration of inflation in 2005 to 3.6% is influenced by a price increase in housing costs, incl. electricity price increase on 1<sup>st</sup> of March. A slowdown of the inflation rate is expected in coming years.

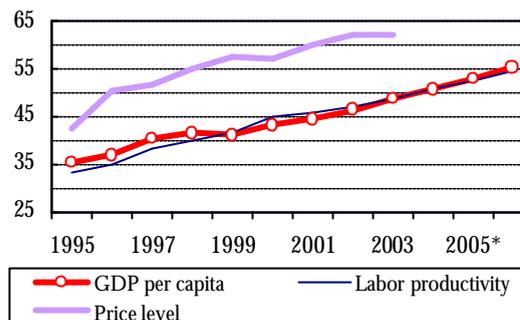
**Diagram 1**

**Main indicators of Estonian economic development compared to EU member states**  
(per cent)

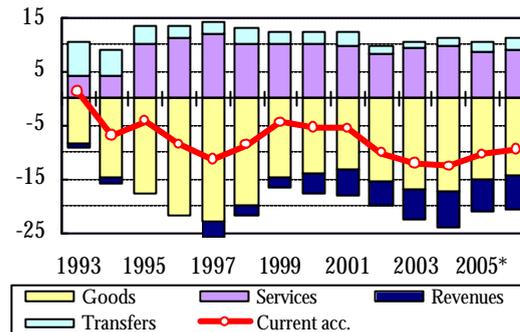
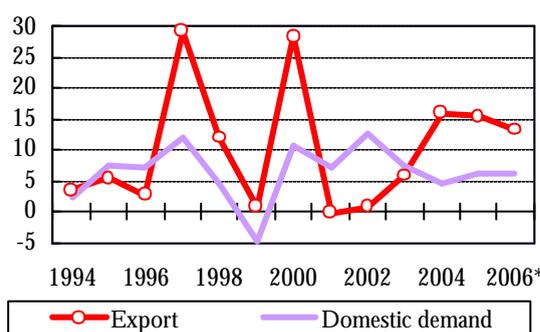
**A. Economic growth**



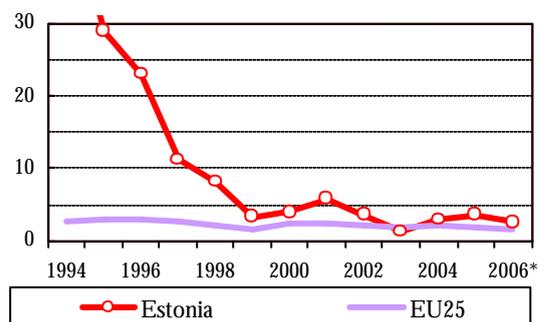
**B. Real convergence with the EU (EU25=100)**



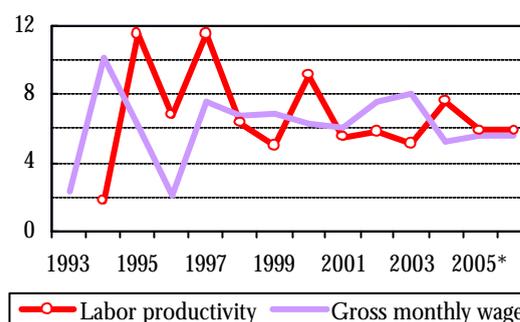
**C. Real growth of domestic demand and export**      **D. Current account structure (% of GDP)**



**E. Inflation**



**F. Real growth of productivity and wages**



Labour productivity – GDP per employee.

PPS (purchasing power standard) – purchasing power parity.

Sources: Estonian Statistical Office, Eurostat, Ministry of Finance, European Commission Spring 2005 Economic Forecasts.

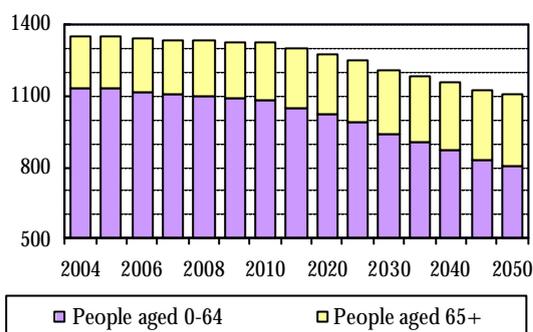
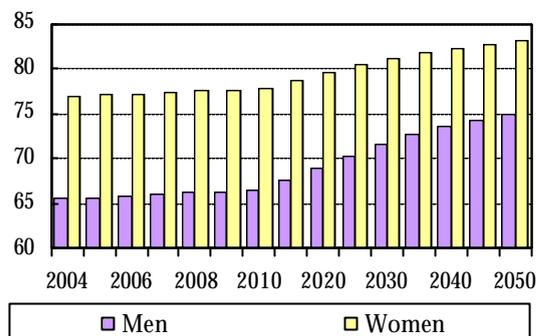
**Fiscal position and its long-term sustainability.** Estonia has been one of those countries in the EU, which has already achieved a balanced or surplus fiscal position as it is determined by the Stability and Growth Pact. In 2004 Estonia achieved a fiscal surplus of 2.4 billion EEK or 1.7% of GDP. The development of the fiscal position in 2004 was characterized by a rapid decrease in

deficits of local authorities to 0.2 billion EEK from almost 0.6 billion a year earlier. Key factors in 2004 were also the reduction in the surplus of the Social Security Funds and government sector as compared to 2003. The fiscal surplus of general government is based to a great extent on smaller expenses compared to the budget, while the share of surplus income of revenues was smaller compared to previous year. The reason behind the decrease in the surplus of the Social Security Funds was the low cost base of the Unemployment Insurance Fund in the starting-years. On the other hand, the costs of the Health Insurance Fund have increased. In order to ensure the balanced budget of the latter in the future, supplementary measures need to be enacted.

Due to the low debt level of general government and the balanced budget every year, and also successfully completed pension reform, Estonia seems to be in a relatively good position to cope with the expenses related to ageing population. However not everything is done yet. The fiscal position seems to be sustainable according to today's decisions and continuing present policies, but in the long term, this might not guarantee a sufficient pension level or quality of health care.

Estonian population has constantly declined starting from the beginning of the 1990's. If in the beginning the primary reason was migration, then during the last few years the age structure of the population has clearly changed. Regaining of independence can be considered as the starting point for the ageing trend of the population through the constant increase in the number of those 65 years old or older, and the sudden drop in the birth rate. After the years of the "Singing Revolution", the birth rate has dropped below the population renewal rate. The decrease in the number of children and increase in life expectancy has inevitably raised the number of older people in the population. If the percentage of those over 65 was 11.5% in 1990, then today they form 16.2%, and by 2050 it will increase to 27% of the population.

According to current forecasts (from the European Commission and the Ministry of Finance of Estonia), the Estonian population will decrease approximately 17–18% within 50 years. The forecast assumes that the birth rate will increase compared to the current level, but will not increase sufficiently to guarantee the 2.1 children per woman necessary to maintain the population. By 2050, the gross birth rate coefficient will reach 1.6 (in 2001 was 1.39). The average life expectancy of men born in 2050 will be almost 10 years longer than the ones born today. Women, however, will live fairly of 7 years longer. As a result of the low birth rate and sudden increase in the average life expectancy, the ratio of working people and pensioners will decline (the dependency ratio of the pension system). In 1992, there were 2 working people per each pensioner in Estonia. Currently the dependency ratio has dropped to 1.8. According to the forecasts, in 2050 there will be only 1.27 working people per each pensioner. These developments put great pressure on social security, and therefore, it is necessary to implement measures to guarantee the sustainability of pension and health insurance.

**Diagram 2****Forecasts of Estonian demographic trends****A. Estonian population (thousands of people)****B. Average life expectancy (in years)**

Source: Ministry of Finance, Estonian Statistics Office.

**Taxation policy.** Starting from 1994, the goal of Estonian taxation system has been to motivate entrepreneurship and initiative, and to rather tax consumption instead of earnings. At the same time, attempts have been made to keep the system simple and transparent, with as few exceptions and differentiations as possible. Since our current taxation system has guaranteed the economic growth and allowed the state to function, there is no direct need for fundamental reforms. On the ground of recent developments in international taxation policies, Estonian labour is still highly taxed, and therefore, it is necessary to make changes in this field.

To improve employment, the government is reducing the taxation of labour. At the same time, environmental fees and taxes are being increased for the purpose of improving environmental protection. Although the Estonian taxation system is characterized by very few exceptions or tax benefits, current exemptions and deductions are being further analyzed. Tax exemptions are expensive for the state and ineffective, and in reality the addressed target group does not often benefit from it or the intended effect is not achieved.

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Estonia's economic development to date has been favourable and the same applies to the prospects for the near future. At the same time, some imbalances and risks have appeared that must be dealt with. The main role of the state in economic development is to create a favourable environment and stability – at the moment our risks in the economic environment are related to a fast increase in credit growth and a large deficit in the current account. Although the Estonian state does not interfere very much in the economy, fiscal policy still has a role to play in economic policy, and we need to adjust our taxation system and redesign the expenditure side of our budget so that it supports economic development even more. In addition, the long-term sustainability of fiscal policy must be guaranteed in conditions of ageing population.

Guaranteeing a stable economic environment, allocation of budgetary resources into economic growth, and guaranteeing long-term sustainability are the three fields of activity on which Estonia's macroeconomic policy will concentrate in the next few years.

## **OBJECTIVE 1: Ensuring a stable macroeconomic environment**

### **Measure 1.1: Keeping the general government fiscal position in accordance to medium-term budgetary objective**

#### **Activities**

- o Preparation of the general government budget at least in balance every year.
- o Strengthening of local authorities financial capability by systematizing rules and increasing the revenue base.

Estonia values conservative fiscal policies and economic administration. This principle is in accordance with the obligation accepted by the EU member states to bring their fiscal positions into compliance with the medium-term budgetary objectives (MTO). The goal of the government is to keep the general government budget in balance, and in some conditions, a more stringent position is necessary. A balanced budget policy guarantees a favourable and stable environment for economic development and contributes to economic growth by stabilizing inflation and contributes to consumers and investors' trust. Such fiscal policy guarantees that debt loads will remain at low levels, which is one of the preconditions for long-term fiscal sustainability and thereby makes it possible to cope with demographic trends (i.e. the aging of the population).

Despite the fact that we have set a nominally balanced budget as our goal, our budgetary policy has proven to be countercyclical in practice. Setting the goal of a nominally balanced budget has justified itself for Estonia, since there have been great structural changes in the economy, it has not allowed a sufficiently trustworthy evaluation of economic cycles or of the cyclical budgetary position. In coming years, the government plans to continue the annual balanced budget rule. In case of different economic developments, the actual position of the budget may differ to the extent of the influence of automatic stabilizers. At the same time, we will continue to work on the development of methodology to evaluate cyclically adjusted budgetary positions.

To strengthen the financial position of local authorities, in recent years, their share in personal income tax receipt has been increased. When state initiated the process of reducing the income tax rate, the basis for distributing the personal income tax was changed – instead of 56% of all tax receipt, the local authorities' portion was specified as 11.2% of the taxpayers gross income, which means that with the decrease in income tax rate, the share received by the local authorities will not fall. By today, the share has been increased to 11.6%, and in 2006, it will again rise to 11.8%. In addition, the opportunities for the local authorities to develop transport infrastructure was increased in 2005. The planned change in regulation determines that at least 10% of the state budgets resources provided for road maintenance would be allocated for investments in local roads. The Ministry of Finance is preparing changes in the Rural Municipality and City Budgets Act. These are directed at improving the financial discipline of local authorities and inducing local authorities to conservative budgeting, and will have long-term effects on their deficits.

#### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level in 2008</b>
<b>Measure 1.1 Keeping the general government fiscal position in accordance to medium-term budgetary objective</b>		
The budgetary position of government as % of GDP	The 2005 general government budget was prepared in balance.	The general government budget is every year prepared at least in balance. The actual budgetary position may differ from the projections due to cyclical developments.

## **Measure 1.2: Becoming a full member of the European Economic and Monetary Union and introduction of the euro**

### **Activities**

- o Implementing economic policies that ensure the fulfilment of the Maastricht criteria.
- o Bringing legislation into compliance with the requirements for the introduction of the euro.
- o Making preparations to guarantee technical preparedness.

Estonia's goal is to become a full member of the European Economic and Monetary Union (EMU) as quickly as possible, in order to improve long-term economic development and monetary stability. The earliest possibility for the introduction of the euro is January 1, 2007. Based on this goal, Estonia joined the exchange rate mechanism (ERM II) starting on June 28, 2004. We participate in ERM II within the standard fluctuation range and maintain the stability of the achieved exchange rate by maintaining the monetary committee system as a unilateral obligation. With the introduction of the euro, Estonia must fulfil the convergence criteria specified in the EU Maastricht Treaty. Most difficult for us is to fulfil the criteria of price stability – in current situation, where inflation in Estonia is accelerated by rises in oil prices in world market, it is important to control administrative price increases. In order for Estonia to be able to fulfil its goal of a rapid introduction of the euro, it is important to continue current conservative economic and budgetary policies.

On 1<sup>st</sup> of September, the Government of Estonia approved the National Changeover Plan, which provides guidelines to government institutions and information for the general public, in order to prepare for transition to the euro. The plan for the transition to the euro<sup>4</sup> includes all the necessary activities to guarantee legal and technical preparedness for introduction of the euro.

### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level</b>
<b>Measure 1.2 Becoming a full member of the European Economic and Monetary Union and introduction of the euro</b>		
Compliance with Maastricht convergence criteria	Currently Estonia does not fulfil price stability and exchange rate criteria.	Estonia fulfils the Maastricht convergence criteria and will be technically ready for introduction of the euro by the middle of 2006.
- general government fiscal position	Budgetary surplus in 2004 was 1.7% of GDP.	The fiscal deficit of the general government may not exceed 3% of GDP.
- general government debt	5.5% of GDP at the end of 2004.	The general government debt ratio may not exceed 60% of GDP, if the debt is greater, a clear tendency for reducing the debt must be apparent.
- price stability	In August 2005, Estonia's 12-month HCPI was 4.1%, and the reference value was 2.4%.	The average inflation rate of last 12 months may not exceed by more than 1.5%points the average of the three best performing member states in terms of price stability.
- long-term interest rates	In May of 2005, Estonia's interest rate was 4.2% and reference value 5.5.	Long-term interest rates may not exceed by more than 2%points the average of the three best performing member states in terms of price stability.

<sup>4</sup> For more details, see the Ministry of Finance's website: <http://www.fin.ee/index.php?id=13324>.

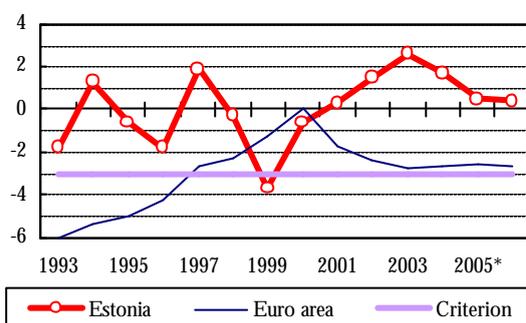
Indicator	Current level	Projected level
- exchange rate stability	The exchange rate of the kroon is fixed to the euro and therefore it remains within the allowed fluctuation band. At the same time, Estonian has not been a member of ERM II for the required 2 years.	Member state has respected the normal fluctuation margins provided for the ERM II without severe tensions for at least 2 years before the examination, and shall not have devalued its currency against any other member state's currency.

**Diagram 3**

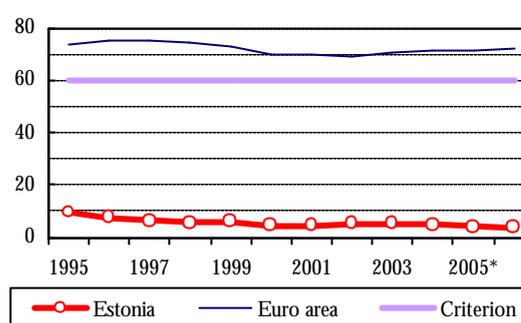
**Fulfilment of the Maastricht convergence criteria**

(per cent)

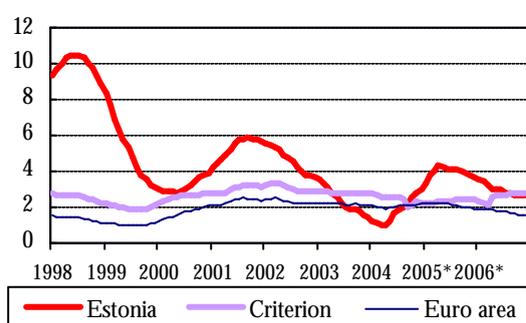
**A. General government balance (ESA 95, % of GDP)**



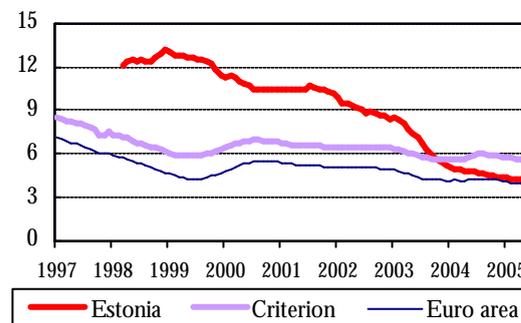
**B. General government debt ratio (ESA 95, % of GDP)**



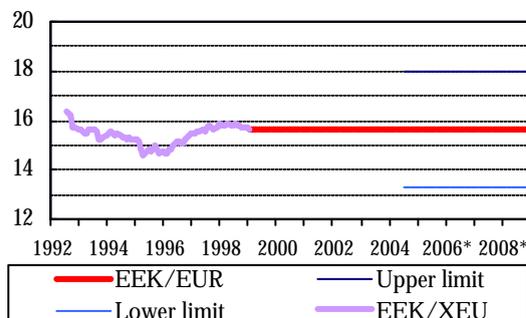
**C. Inflation**



**D. Long-term interest rates**



**E. EEK/EUR exchange rate**



Sources: Estonian Statistical Office, Eurostat, Ministry of Finance of Estonia, European Commission Spring 2005 Economic Forecasts.

### **Measure 1.3: Managing the risks affecting balanced economic development**

#### **Activities**

- o Reducing the current account deficit and controlling the increase in credit growth.

For decreasing the speed of the credit growth and thereby reducing the current account deficit, the Bank of Estonia has kept the reserve requirement for commercial banks at 13%. At the same time in the Euro system, the reserve requirement is 2%.

Since 2005, the maximum limit of mortgage interest, schooling costs, as well as gifts, donations, and labour union entry and membership fees that can be deducted from income tax was reduced by 50% to 50,000 EEK per year. This measure has an influence that is similar to an increase in interest rates, and should help to limit consumption and credit growth. In addition, at the end of last year, the range of people receiving KredEx Foundation guarantees for home loans was limited and the maximum upper limit of loan guarantee was reduced from 400,000 EEK to 300,000 EEK.<sup>5</sup>

The primary measure for containment of credit growth and current account deficit is a conservative fiscal policy – domestic demand has been limited by the surplus of general government in recent years, and also in the future, government will compile a budget that is at least in balance. Promoting savings (for example with pension reform) and export development also contribute to that. See Part Two (Measure 4.4) for activities related to increasing productivity and export development.

#### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 1.3 Managing the risks affecting balanced economic development</b>		
Current account deficit as % of GDP	The current account deficit in 2004 was 12.5% of GDP and a deficit of 10.4% is projected for 2005.	The current account deficit approaches a sustainable level <sup>6</sup>

<sup>5</sup> Certain target groups (forced tenants, young families, young specialists with higher education) are offered additional home loan guarantees through KredEx, so that they can obtain home loans with smaller self-financing (10%).

<sup>6</sup> The IMF has estimated that in the case of countries like Estonia, the sustainable level for current accounts deficits is 6–7% of GDP.

## **OBJECTIVE 2: Ensuring the long-term sustainability of fiscal policy**

### **Measure 2.1: Ensuring long-term sustainability of pension system and guaranteeing sufficient living standard for pensioners**

#### **Activities**

- o Completion of pension reform, implementation of reforms for special pensions, old-age pensions under favourable conditions, and superannuated pensions.
- o Raising the retirement age to 63 years by 2016.
- o Increasing the tax base for state pension insurance.

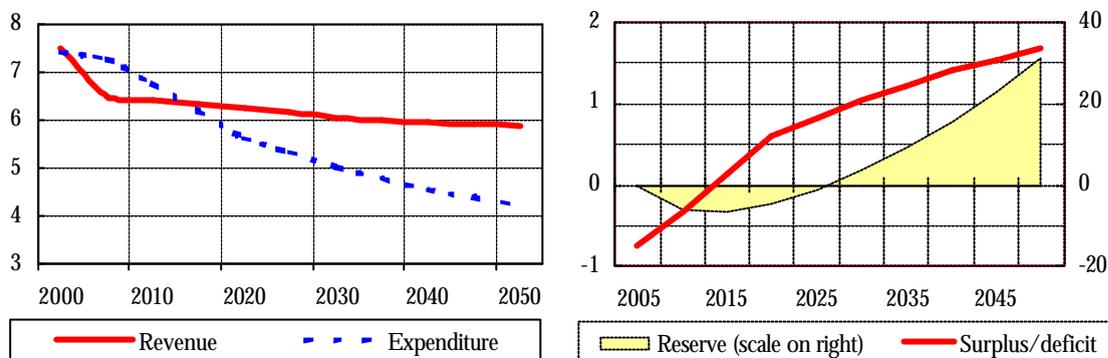
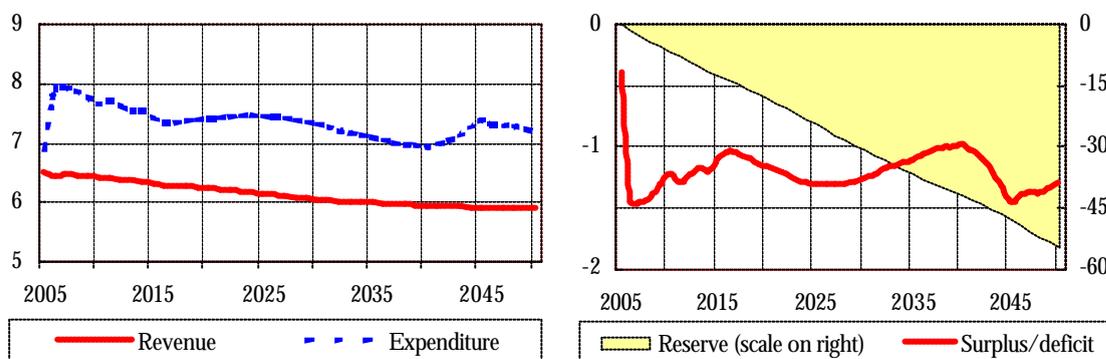
To ensure the sustainability of the public finances under the conditions of ageing population, Estonia has, to a great extent, carried out pension reform and created a three-pillar system (mandatory PAYG pension insurance, mandatory funded pension, and supplementary pension). With the reform, the retirement age was raised and the retirement age for men and women will be equalized step-by-step. The retirement age for women will reach the common level – 63 years – in 2016. The average age for leaving the labour market in 2003 was 60.8. A range of special pensions (defence forces, police, etc.), early retirement old-age pensions, old-age pensions under favourable conditions, and superannuated pensions provide the opportunity to retire before the general retirement age. In 2004, 42.1% of pensioners retired before the general retirement age. There are plans to reform the payment of special pensions, old-age pensions under favourable conditions, and superannuated pensions.

In order to find supplemental resources to finance state pension insurance (and also health insurance) the government will return to the original idea of pension reform, according to which the minimum social tax liabilities must be completed from the minimum monthly wage. In 2006, the minimum commitment will be increased step-by-step from the current 1,400 EEK per month to the monthly minimum wage in 2009. The problem is also that the current level of commitments does not provide sufficient length of service for people and will result in a small pension in the future.

Increased sustainability is also supported by an increase in employment rate – more taxpayers mean a better ratio between taxpayers and dependents and a better financial situation for pension and health insurance. See Part Three of the Action Plan for measures to improve employment.

#### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 2.1 Ensuring long-term sustainability of pension system and guaranteeing sufficient living standard for pensioners</b>		
Financial position of the state pension insurance as % of GDP	The projected deficit in 2005 is 0.2% of GDP.	Pillar I of the pension insurance is continuously at least in balance and there are sufficient reserves to guarantee liquidity
Replacement rate for pensions (ratio of pension to wages)	In 2003, the replacement rate for First Pillar pensions was 40.5%. Pension from Second Pillar will be supplemented in the future.	The minimum standard of the European Code of Social Security: the old-age pension of a pensioner with 30 years of service must be at least 40% of average net wages of a male labourer.

**Diagram 4****Forecast of the pension insurance financial indicators***(% of GDP)***A. Scenario by carrying on today's policies (pension increase based on conservative index)****B. Remaining the wage and pension ratio of 2006**

Source: Ministry of Finance, Estonian Statistics Office.

## Measure 2.2: Ensuring long-term sustainability of health insurance system and guaranteeing people's financial security in case of health risks

### Activities

- o Increasing the tax base for health insurance.
- o Increasing the population's coverage with health insurance.
- o Considering a reduction in health insurance liabilities.

So far, the financial position of health insurance has been stable. However, considering Estonia's demographic situation, it is necessary to implement supplementary measures in order to ensure long-term sustainability. The basic principle is to maintain at least a balanced financial position of state health insurance fees. At the same time, the high-quality services for people must be provided.

Similarly to pension insurance, the financing of the health care system can be improved by increasing the tax base by raising the basis of the minimum commitment of social taxes (see Measure 2.1). To guarantee the long-term sustainability of health insurance in circumstances of ageing population, enlargement of the range of people for whom social tax is paid, is considered. At the same time attempts are made to avoid the further increase in the share of people equal

with the insured ones. In the present situation, 47% of the individuals covered by health insurance are directly taxed individuals and 50% are people who are equal to the insured under the solidarity principle, for whom social taxes are not paid.

In Estonia, 94% of the population is covered with health insurance. The costs of emergency medical care for the uninsured 6% of the population is covered by the state budget, and these costs are growing rapidly. Increasing the health insurance coverage of the population will improve the timely accessibility of medical care. To avoid pressure on the health insurance budget, individuals should be taxed directly or by the state/local authorities. Health insurance expenditures for financial and non-financial compensation will be managed and optimized, maintaining expenses at the current level and also taking the society's needs into consideration. Reducing the extent of liabilities of the Health Insurance Fund has been considered as a possible means for saving.

The promotion and encouragement of healthy lifestyles and general improvement of the general health of the population, which reduces the number of people requiring medical care, plays an important role in ensuring the long-term sustainability of health insurance. For specific activities, see Part 3 (Measure 8.2).

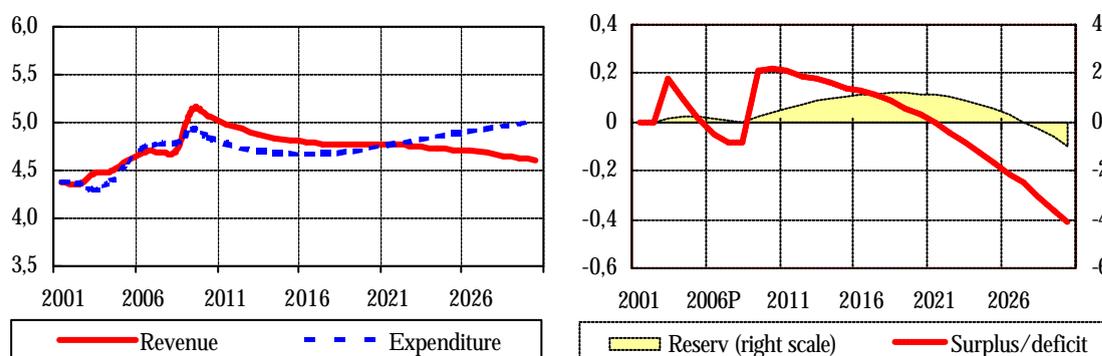
### Indicators

Indicator	Current level	Projected level 2008
<b>Measure 2.2 Insuring long-term sustainability of health insurance system and guaranteeing people's financial security in case of health risks</b>		
Financial position of the Health Insurance Fund as % of GDP	The projected 2005 surplus is 0.05% of GDP	The health insurance fund is continuously at least in balance and there are sufficient reserves to guarantee liquidity
Coverage of the population by health insurance	94% in 2005	99% of the population is covered by health insurance
Patient satisfaction with the quality of health care	In 2004, 59% of the insured considered medical care to be good or rather good	Patient satisfaction is at least at the same level as today

### Diagram 5

#### Forecast of the Health Insurance Fund financial indicators

(% of GDP)



Source: Ministry of Finance, Estonian Statistics Office.

## **OBJECTIVE 3: Direction of the fiscal policy to improve the economic growth and employment**

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### **Measure 3.1: Reorganizing the tax system with more emphasis on taxing the consumption and exploitation of environment compared to labour**

#### **Activities**

- o Reducing the taxation of labour.
- o Higher taxation of consumption and exploitation of the environment.
- o Evaluating effectiveness of the tax benefits and reducing benefits in case of need.

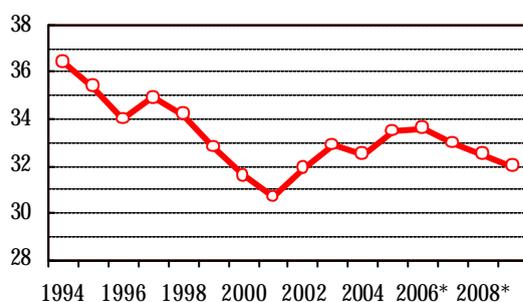
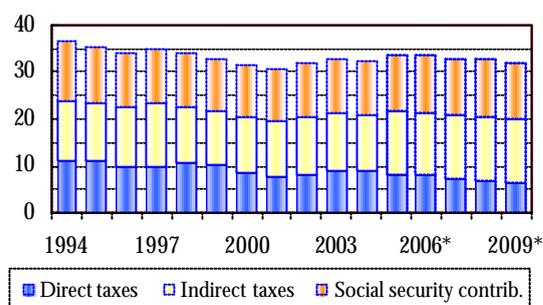
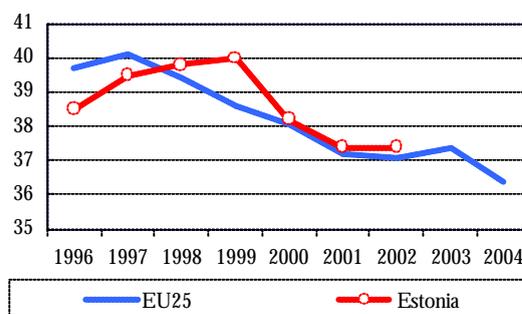
With the help of partial reorientation of taxes government has set a goal of shifting the tax burden from taxing income to taxing the use of natural resources and the pollution of the environment. To reduce the taxation of labour, the income tax rate will be decreased to 20% by 2009, and the minimum tax exemption will be raised to 2,000 EEK per month in 2006. The further increase of the minimum tax exemption is planned, incl. reduction of tax benefits. In addition, a reduction of unemployment tax rates is possible in 2006.

On 7<sup>th</sup> of July 2005, the government approved the initial basis of the ecological tax reform. By reorganizing the taxation system, the government wishes to appraise the natural resources and environment. The initial basis for ecological tax reform does not include specific proposals for increases in the tax rate, but describes potential measures. Grounded to this initial basis, specific measures for achieving the goals of ecological taxation reform will be worked out. The draft for environmental fees has been composed and approved by the government. Higher taxes and increasing environmental fees, on the one hand, provide additional revenues, which cover the effects of reduced labour taxes, and on the other hand, reduce activities that are harmful to health (and also to industry and economic growth) and environment. The tax burden will not increase as a result of the implementation of ecological tax reform measures.

There is planned a critical review and abandonment of tax benefits that no longer fulfil their initial purpose or are unreasonable. In case of each tax benefit, it will be assessed whether it is proportional to the desired goal, whether it fulfils the expectations and needs of the society, and whether it is most rational to achieve this goal through tax benefits. If necessary, the benefits will be provided with time limits, during which it will be possible to analyze the effectiveness of the benefits in realizing the goals and based to the analysis to decide on the extension of the benefits. For instance there is considered a reduction of the limit for tax exemptions for of mortgage interest or abolishment of this benefit, as due to the simplification of obtaining housing loans and reduced interest rates, the need for state providing benefits has decreased. At the same time there are plans to limit the tax exemptions of interest-payments from credit institutions to individual persons to interest-payments of deposits, as it has been the initial goal of the tax law. From 1<sup>st</sup> of July 2007, the 5% VAT on heating energy, such as heating peat, briquettes, coal, and firewood will be replaced with an 18% tax rate.

**Indicators**

Indicator	Current level	Projected level 2008
<b>Measure 3.1 Reorganizing the tax system with more emphasis on consumption and sustainable development compared to labour</b>		
Income tax rate and minimum level of tax exemption	The rate in 2005 is 24% and tax-free income of 1,700 EEK per month	Rate of 20% in 2009. In 2006, the exemption will be 2,000 EEK and a future increase to the minimum wage level is planned
Direct and indirect taxes as a % of GDP	In 2004, direct taxes constituted 8.8% and indirect taxes, 12% of GDP	A reduction in the percentage of direct taxes and an increase in the percentage of indirect taxes
Tax burden of low-wage earners <sup>7</sup>	37.4% of labour costs in 2002	The lowering of the tax wedge from the current level

**Diagram 6****Tax burden***(Percentage of GDP)***A. Tax burden in Estonia****B. Structure of Estonia's tax burden****C. Tax burden of low-wage earners**

Source: Ministry of Finance, Estonian Statistics Office, Eurostat

<sup>7</sup> People who receive 67% of the average worker's wages are considered to be low-wage earners. The average worker is defined as a production worker in a processing industry.

### **Measure 3.2: Greater and more efficient allocation of budgetary resources to activities supporting growth and employment**

#### **Activities**

- o Maintaining the high level of public investments.
- o Increasing expenditures for research and development activities.
- o Increasing the financing of vocational education.

To improve economic growth and employment, it is important to change the structure of budgetary expenses – investments in human capital and infrastructure must be prioritised. Thereby, just increase in expenses should not be primary. The goal is to achieve greater output and increased quality. Examining Estonia's budgetary structure, it is noteworthy that despite a relatively low tax burden, we invest more into our economic development – both in education and in physical capital. We have clearly preferred investments instead of providing state aid.

As regards to public investments, Estonia is at the forefront of EU member states and we plan to continue in the same manner. Estonia's expenditures in educational sector are also relatively high compared to other member states, and the goal is to maintain them at the current level. The priority is to finance vocational education. At the same time, Estonia's expenditures for research and development (R&D) are low. Private sector has the main role to play in the increase of R&D expenditures, since the level of expenditures in the public sector in Estonia are similar to the EU average. At the same time, supplementary resources are directed at an active labour market policy. For more details about this field of activity, see Parts 2 and 3 of the Action Plan.

With the 2005 supplementary budget, about 500 million EEK is planned to allocate for investments, additional money will be put to education, R&D, and labour market policies. With the supplementary budget, in total, about 0.5% of GDP will be directed toward economic and employment development. The larger allocations include 158.1 million EEK for road construction, 67.9 million for vocational education, 41.9 million for active labour market measures, 36.5 million for implementing a R&D strategy, and 20 million for starting up a Development Fund.

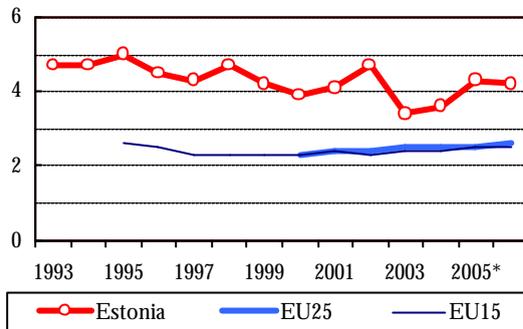
The priorities of the state budget for 2006 are social sector, healthcare and education. The draft-budget provides more than a billion EEK for R&D activities, which is 17% more than in 2005. According to the plans, the field of vocational education should get 207,8 million EEK extra, compared to this year's budget. The expenditures to vocational education will grow 23,5%. 3,8 billion EEK from the state budget (2,2% from GDP) is planned for the investments, which is 563 million EEK (17,2%) more than in 2005. For the construction and maintenance of roads, the planned allocations are 239 million EEK higher than this year, thereby 137 million EEK is additionally allocated to local roads.

Generally Estonia does not support setting the goals concerning expenditures. The volume of expenditures, after all, depends on the economic situation and the budgetary possibilities and has to be in accordance with the absorption ability of the sphere. See Part 2 of the Action Plan for the planned volume of R&D expenditures (Measures 4.1 and 4.2).

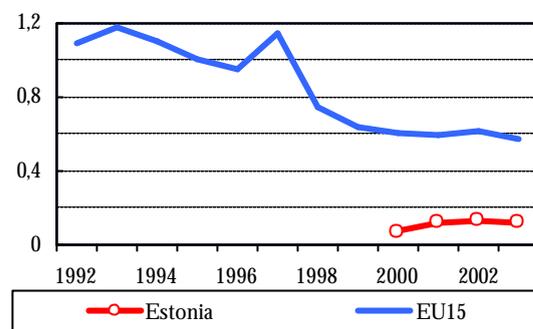
**Diagram 7**

**Government investments into physical and human capital**  
(% of GDP)

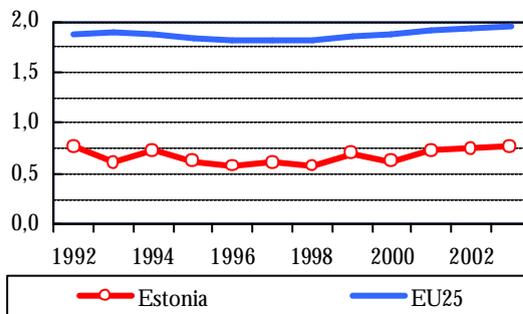
**A. Public sector stock investments**



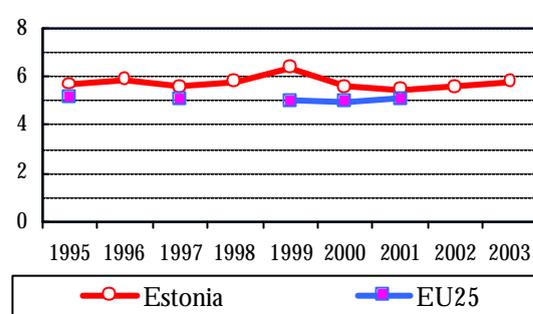
**B. State aid**



**C. Expenditures on research and development**



**D. Public sector expenditures for education**



Sources: Estonian Statistics Office, Eurostat.

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## **PART 2: A KNOWLEDGE-BASED AND SUSTAINABLE BUSINESS ENVIRONMENT**

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By today, Estonia has completed one development cycle and a large number of companies with strong market potential and good prospects for future development have been established. At the same time, companies operating in traditional sectors dominate in the Estonian economy, and their productivity and profitability per employee is significantly smaller than the respective indicators in industrial countries. There are many reasons for this. The most important is the small size of the economy (GDP), technological backwardness, weak international market position, management mistakes, and weak capital structure.

In open market conditions, Estonian enterprises sharply feel the competitive pressure of foreign markets. The future of many companies is complicated due to the growing prices of production equipment. Important structural changes are already taking place - the international consolidation of providers of consumer goods and services (communications, retail banking, transport, etc.), the movement of subcontracting (in places, already out of Estonia, for instance in textile sector), the increase in the vulnerability of resource-based and capital-intensive transport and transit industry (the added value of the intermediary in the value chain decrease), and the lack of skilled labour. These developments will probably spread to other branches of industry with low profitability and great labour cost sensitivity. Generally, the greatest challenges are related to increasing business profitability (currently 50% of the EU average), and improving export performance. To be sustainable in conditions of increased competition tomorrow's companies must be more innovative, productive and profitable than today's.

If during the first years of economic reform the challenge was to reduce the role of the state in the management of the economy, then the roots of tomorrow's economic growth are hidden in hard state decisions and individualized approaches to the problems of different types of companies. The forthcoming challenges cannot be solved at the single company or organization level, whereby the active role of the state and regulations in overcoming market failures, structural changing of the economy, and increasing the competitiveness of the economic environment is unavoidable.

Despite the small size of the Estonian market, only 3,500 companies operate in external markets and 30 leading companies generate 50% of all the export revenues. From the point of view of the growth of companies, this is a critically important problem, for the solution of which it is necessary to support systematically the entry of companies into external markets.

To increase productivity, it is extremely important to place greater emphasis on research and development (R&D) and innovation. The Estonian economy is characterized by a comparatively low level of R&D investments in comparison to other EU countries. In 2003, the total R&D expenditures in Estonia were 0.82% of GDP. Company investments into R&D form only 33.4% of total R&D expenditures in Estonia, as opposed to an EU average of 55%.

Currently, the innovativeness of Estonian companies most often takes the form of utilization of new technologies. Only 5% of Estonian businesses are strategic innovators, who could be the developers and marketers of potential "star products". In countries with strong innovative potential like Sweden and Finland, the situation is the opposite, and strategic and periodic innovators constitute the largest group, while at the same time the percentage of the utilization of technology among innovators is smaller.

In today's capital markets, it is complicated for innovative companies (strategic innovators) in the initial phase to acquire capital, and this significantly hinders the creation and growth of companies. Start-up companies often also lack managerial know-how and experience. One solution is that the state should promote investment in the equity of innovative companies with great growth potential. Such investments will also be accompanied by managerial know-how that can contribute to the development of enterprise sector in conditions when the market cannot do so.

For potential users of technology, the problem is finding the necessary technology, its high cost, and the shortage of people who are able to work with new equipment. In this context, the role of the state is to train the necessary people and to distribute risks by the use of support measures for the entrepreneurs aiming to start up an innovative project in order to move more and more in the direction of knowledge- and skill-based activities.

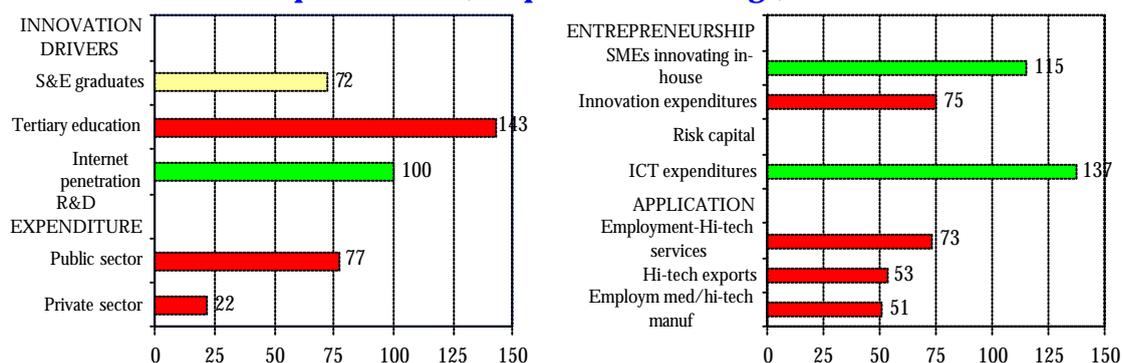
The competitiveness of the companies is also directly related to developments in the labour market. Rapid economic growth and an increase in competitiveness provide momentum for the creation of jobs, and together with an increase in productivity, increase workers' incomes. A higher employment rate and lower unemployment will reduce possible problems in fiscal policy. First of all, in this context, attention must be paid to increasing the competitiveness of small and medium-sized enterprises (SMEs).

Estonian SMEs employ 330 505 workers and their share in the total number of employees in enterprise sector is constantly rising. In addition to being an important source of new jobs, SMEs are considered to be the engines for future growth. Today, Estonian SMEs contribute to value creation by producing 53% of the GDP. Through this, they contribute highly to the development of country's economic and social life and should therefore be the foremost target of Estonian enterprise policy programmes.

## Diagram 8

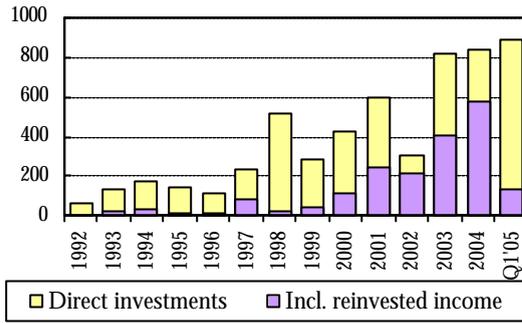
### The basic indicators of the Estonian business sector

#### A. Estonian innovation performance (compared to EU average)<sup>8</sup>

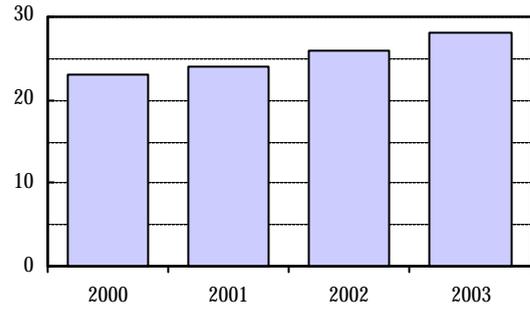


<sup>8</sup> European Innovation Scoreboard 2005

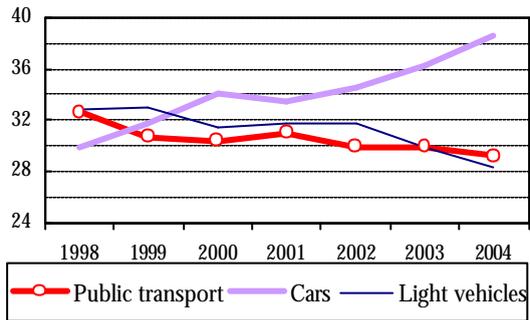
**B. Direct investments in Estonia (EUR)**



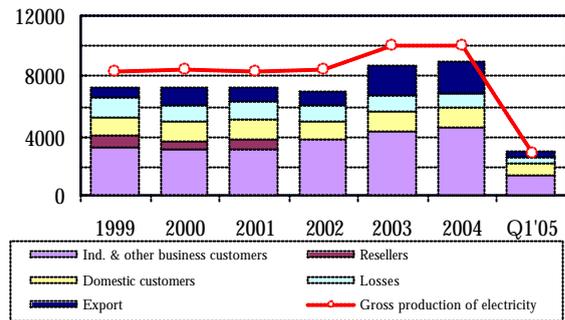
**C. Operating companies per 1,000 residents**



**D. Usage of means of transport by employed population**



**E. Production of electricity (GWh)**



Sources: Estonian Statistics Office, Bank of Estonia, Ministry of Economic Affairs and Communications.

## **OBJECTIVE 4: Increasing the quality of research and development, as well as the capacity for innovation, growth, and long-term international competitiveness**

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Every year the government has increased the volume of investments in research and development. According to the draft State budget for 2006, the nominal increase in R&D investments compared to 2005 is 17%. The private sector's R&D expenditures have likewise increased by over 10% annually. Estonia has also been very successful in using foreign financing for research and development owing to the successful participation of Estonian researchers in international programmes. In 2003, the proportion of foreign investments was almost 15% of the R&D expenditures of the public sector. However, due to rapid economic growth and statistical changes it has proved to be rather problematic to increase the share of R&D investments in the GDP, as a result of which the GDP has grown at a faster rate than the government has managed to finance R&D. For instance, an approximately 17% nominal increase in R&D expenditures in the state budget in 2006 would thus mean a mere 0.05% increase in R&D expenditures / GDP ratio.

Taking into account, apart from rapid economic growth, the real absorption capacity of the R&D sector and the low base level of R&D investments, it seems quite unrealistic to achieve a 3%-level as soon as by 2010. So the government's goal will be to raise the public sector's R&D expenditures to reach 1.05% of the GDP by the year 2010, and continues to increase it in the following years. A steady rise in public investment will allow the government's goal for 2010 to be that the total R&D expenditures should make up 1.9% of the GDP.

In the framework of Lisbon Strategy the Heads of State and Government agreed that the level of R&D investments must increase to reach 3% of the GDP. The Estonian Government aims to achieve this objective by 2014. Besides that it plans to raise the share of public investment to 1,2% of the GDP.

The guiding principle of the government has been to set realistic and achievable goals and guarantee their fulfilment. Therefore, its goals are based on conservative estimates. Estonia's problem is primarily the low proportion of its R&D expenditures in the private sector. The above goals were set on the basis of conservative growth in private sector expenditures, taking that the growth rate of enterprise sector R&D investments would remain the same as in 2000–2003, when no direct measures were implemented for encouraging private sector R&D expenditures. However, the measures foreseen in this Action Plan for increasing private sector expenditures (first and foremost through more sizable state investments in the development of the private sector, using EU structural funds and the necessary co-financing) allow us to expect a more rapid increase in private sector expenditures than projected.

A faster rise in R&D expenditures assumes significantly greater human resources, which is one of the main preconditions for a more brisk expansion of research and development in both the public and private sector. So one of the most important priorities set in the Action Plan is the development of human capital. Both public investments and a rapid expansion of infrastructure and human resources create a basis for a faster increase of R&D expenditures after 2010.

To use the R&D investments more effectively, the government adopted in 2001 the R&D Strategy "Knowledge-based Estonia 2002-2006", setting two main priorities - to increase the knowledge pool and to improve the competitiveness of enterprises. Regarding these as the key areas for gaining competitive advantages, the government is currently working out a new R&D

Strategy for the years 2007-2013, elaborating the measures and activities envisaged by both the present strategy and the Estonian Action Plan for Growth and Jobs and setting new objectives for the next programming period of the EU structural funds.

#### **Measure 4.1: Ensuring the sustainability and improving the quality of research and development**

Research and development is the primary success factor in modern economies. Studies show that productivity increases of up to 40% are related to R&D investments, which positively influence other fields of economy.<sup>9</sup> People involved in R&D constitute the human resource on which a truly knowledge-based economy is based.

The current problems in Estonia's R&D are primarily related to the small size of the R&D system, especially in terms of people and infrastructure, of no lesser importance being that its quality lags behind world standards, that it is not sufficiently able to react to priorities, and that it is weakly connected to Estonia's socio-economic objectives, incl. cooperation with business.

Even though Estonia has been very successful in attracting foreign direct investments, the latter have so far mostly been made in sectors that are not especially knowledge- and skill-intensive, and have to a large extent been lured by low labour costs. Given that Estonia is losing its cost-based competitive advantage, it will be crucial to create an attractive environment for knowledge-intensive foreign direct investments. Therefore, it is highly important to raise the international competitiveness of the country's R&D and create a critical mass of human resources in areas with a high growth potential.

#### **Activities**

- The introduction of foresight activities to establish the fields with greater potential economic influence and work out the principles of their preferential development (2006).
- The introduction of national programmes in the key areas of Research and Development Strategy<sup>10</sup> and other priority fields, in order to achieve a greater influence and effectiveness of R&D in selected fields by concentrated promotion, and to improve cooperation between enterprises and research institutions (preparation in 2006, start up in 2007).
- Raising the quality and effectiveness of R&D, incl. increasing the volume of grant, targeted and baseline financing, with the aim of opening new research topics and improving the financing of research positions, thereby creating more competitive working conditions (2007–2013).
- The development of the number of the Centres of Excellence<sup>11</sup>, selected on a competitive basis, by supporting their preferential development and extra funding in order to create and maintain top R&D competence (2006–2007)<sup>12</sup>.
- The development of the necessary R&D infrastructure for the training of researchers and top specialists and creating a competitive R&D environment (incl. raising their capacity to

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<sup>9</sup> Wim Kok's working group report "Facing the Challenge. The Lisbon Strategy for growth and jobs", 3 November 2004; <http://europa.eu.int/growthandjobs/pdf/2004-1866-EN-complet.pdf>

<sup>10</sup> Estonian research and development strategy 2002–2006 *Knowledge-based Estonia* defines the following key areas: 1) user-friendly information technologies and development of the information society; 2) biomedicine; 3) materials' technologies. The R&D strategy that will come into force in 2007 may bring about changes in the definition of key areas. The current strategy is available on the Ministry of Education and Research website [www.hm.ee](http://www.hm.ee)

<sup>11</sup> A Centre of Excellence is a research unit composed of at least one high-level study group, which is connected to doctoral studies and is internationally recognized in its field.

<sup>12</sup> By 2002-2006 10 Centres of Excellence have been confirmed.

participate in the EU R&D Framework Programmes) in accordance with the Research and Development Infrastructure Development Programme and the Strategic Bases for the Modernization of Infrastructure Supporting Academic Higher Education, Research, and Innovation (2006–2007).

- Increasing the procurement of acquisitions (incl. Internet-based ones) to research and archive libraries and improving the conditions of preservation of collections (2006–2007).
- Promotion of a more extensive entry and effective participation in international cooperation networks, incl. initiation of the necessary instruments for participation in the EU R&D 7<sup>th</sup> Framework Programme and the Competitiveness and Innovation Framework Programme; supporting membership in international research organizations and in the Nordic Research Area (2006–2008).
- Introduction of common financing schemes in accordance with international R&D agreements (2006).
- Dissemination of entrepreneurial knowledge and skills in universities and other institutions of higher education, creating entrepreneurial spirit and supporting the creation of regulatory framework conducive for commercialization of the intellectual property created at universities, in order to increase the transfer of knowledge, skills and technology transfer to enterprises (2007).

### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 4.1 Ensuring sustainability of R&amp;D and improving its quality</b>		
R&D expenditures as a % of GDP	In 2003, 0.82% of GDP, of which 34% is in the private sector <sup>13</sup>	1.5% of GDP, of which 40% is in the private sector; in 2010, 1.9% of GDP, of which 45% is in the private sector
R&D personnel as a percentage of persons employed	In 2003, 1.2% (in 2003, the EU25 – 1.55%)	1.45%

### **Measure 4.2: Developing human capital necessary for R&D advancement and long-term international competitiveness of the enterprise sector**

To develop a knowledge-based society and economy, Estonia needs a significantly larger number of researchers and engineers, who on the one hand, will ensure the sustainability and competitiveness of the public sector's R&D and of the system of higher education, and on the other hand, will constitute the human resource for innovative entrepreneurship. For this objective, attractiveness of research and engineering careers must be enhanced among young people and experienced specialists, and measures must be taken to halt the brain drain, to guarantee that a sufficient number of specialists receive doctoral degrees at universities, and to improve the for embarking on successful research careers.

In order to raise enterprises' competitiveness, it is necessary to develop and modernize the knowledge and skills of the workforce of the SMEs (incl. managers), making them conform to the actual needs of the enterprise sector and a knowledge-based economy. In order to intensify in-company training, which will ensure the better utilization of the potential of the developed human capital, it will be necessary to improve the availability of high-quality training on the market.

<sup>13</sup> Source: Statistical Office of Estonia.

**Activities**

- Creation of post-doctoral positions which would allow those who have recently received their doctoral degrees to start their research careers, giving them confidence in their first few years as researchers, and allowing them to get ready for applying for competition-based financing (2006).
- Introduction of a supplementary scheme of doctoral courses to warrant a larger number of doctoral degree holders. Providing possibilities for foreign doctoral students to study in Estonia under on a par with local students, and active measures to attract foreign doctoral students to Estonian universities (2007).
- Development of an internationalization strategy for higher education to improve academic mobility, in the framework of which the participation of Estonian academic staff and students in international cooperation networks will be supported, doctoral and post-doctoral positions in Estonian universities will be opened to foreigners, regular international competitions for selecting academic staff will be arranged, and efforts will be made to improve mutual recognition of diplomas (2007).
- Encouraging expatriate Estonian researchers and top specialists from abroad, to return to Estonia, by creating favourable and attractive conditions at home for either starting or continuing their careers, using both active (return grants) and passive measures (improvement of general environment for R&D) and thereby partially compensating for the brain drain (2007).
- Developing possibilities for student and researcher mobility between research institutions and enterprises in the course of their study and research careers (2006).
- Planning the figures of government requisition for specialists with vocational education, professional higher education, and academic higher education on the basis of the data in the forecast model for labour needs (2008).
- Implementation of a so-called training plan programme and the development of the training grant programme, with the aim of better directing the resources intended for the development of human resources in enterprises; enhancing the development and updating the knowledge and skills of enterprise managers and workers (2005).
- Preparation and availability of necessary training programmes to improve the competitiveness of companies by training trainers or organizing training in those fields in which the required training is currently not available (2005).

**Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level</b>
<b>Measure 4.2 Development of the human capital necessary for the advancement of R&amp;D and long-term international competitiveness of enterprise sector</b>		
Number of students admitted to doctoral courses (per year)	428 <sup>14</sup> in 2004	500 in 2011
Number of graduates of doctoral courses (per year)	138 <sup>15</sup> in 2004	300 in 2015
Percentage of foreign doctoral students	3% in 2004 <sup>16</sup>	10% in 2015 (3,000 foreign students)
Percentage of baccalaureate and master students who have studied as exchange students in foreign universities	0.8% in 2004/05 (Erasmus programme) <sup>17</sup>	5% in 2015
Research and development staff in the enterprise sector (full-time equivalent)	763 in 2003	1,150 in 2008

<sup>14</sup> Source: Ministry of Education and Research.

<sup>15</sup> Source: Ministry of Education and Research.

<sup>16</sup> Source: Ministry of Education and Research, students' register. This includes all PhD students who do not have Estonian citizenship.

<sup>17</sup> Source: Ministry of Education and Research, students' register.

### **Measure 4.3: Ensuring access to capital for start-up companies and those with great growth potential**

The opportunity for a company to obtain the equity and loan capital necessary for financing and implementing business plans depends to a great extent on the size and maturity of the company and the risk level of business idea. In order to direct financial resources into business activities that have greater risks, on one hand, the capability, and opportunities for investors to place their money (and knowledge) in Estonian business must be developed and the interest of banks to offer micro loans must be increased. On the other hand, the ability of small- and medium-sized enterprises to obtain the necessary resources for financing growth must be improved. In addition to the aforementioned activities, improving the access of small- and medium-sized enterprises to European Union structural funds is being dealt with by refocusing support measures and by organizing training seminars and informational events.

#### **Activities**

- The bringing together of potential (foreign) investors and enterprises in need of capital through mediating contacts, in order to direct available capital into Estonian business (2005).
- The start up of a public and private sector cooperation program to promote business start-ups, in order to create comprehensive access for start-up companies to the various benefits and services offered by the public and private sector (2006).
- The development of a network of local business angels, with the objective of directing the investments and knowledge of potential business angels into Estonian enterprises (2006).
- The creation of the Estonian Development Fund in order to offer early-phase equity investments to innovative start-up businesses (2006).
- The development of the knowledge and skills of new and growing companies through training and consultation, in order to improve their ability to obtain equity and loan capital (2007).
- Improving access to information necessary for evaluating the financial capability of companies applying for loans by creating the respective IT environment, in order to make the granting of micro-loans more economically feasible for financial institutions, and thereby to improve the possibilities of the companies to obtain small-volume loan capital (2007).

#### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level</b>
<b>Measure 4.3</b> Insuring access to capital for start-up companies and those with great growth potential		
The share of enterprises reporting access to finance as the most important barrier for growth	21% in 2005	10%

### **Measure 4.4: Promoting an increase in productivity, and supporting companies entering foreign markets and investments for the development of new technologies, products and services**

Despite the small size of the Estonian market, only 3,500 companies are active in foreign markets and 50% of all export income is generated by 30 leading companies. This is also reflected in our

negative trade balance. From the point of view of enterprises' growth, we are dealing with a problem of critical importance, since breaking into foreign markets is currently a great challenge for the majority of businesses.

We are concerned at the fact that subcontracting as a model export is very common in our export, and it is not especially knowledge- or skill-intensive. This, however, means low productivity and low income for entrepreneurs. Therefore, diversified state support for innovative start-ups, but also for more mature companies that wish to move toward knowledge- and skill-intensive activities is extremely important, since this would lead to an increase in the added value created by companies.

The current Estonian R&D strategy has to a large extent been based on the science-driven approach and has been focussing mainly on the creation of knowledge and its transfer to the enterprise sector. This has caused the situation where the innovation policy is focussed on a narrow base of technologically competent firms and consequently has only limited impact on competitiveness of enterprises on a wider scale. That is why in the new strategy period Estonia intends to adopt a more market-driven approach, trying to target with its innovation policy a significantly wider range of enterprises<sup>18</sup> and support a much wider range of innovative activities<sup>19</sup>. While in the current strategic period the main emphasis has put to the modernisation of the R&D infrastructure and building enterprises-university linkages, in the upcoming period more emphasis will also be laid on building the innovation capacities of existing enterprises and supporting the creation and growth of new innovative companies<sup>20</sup>.

### Activities

- Supporting R&D projects directed at the development of new competitive technologies, services and processes, incl. supporting the development of environmentally friendly technologies, which would be possible to successfully market in both Estonia as well as abroad (2005).
- Supporting Competence Centres to promote cooperation between companies and research and development institutions, in order to assemble a critical mass of the competence in a specific field, to make greater use of the knowledge created in universities, and to train additional research and development workers needed by enterprises (2005).
- Conducting innovation audits to chart innovative potential and development obstacles in order to help companies more efficiently use their growth potential (2005).
- The development of services offered by business incubators/development centres in order to provide momentum for the creation and development of companies with great growth potential through more effective support (2005).
- Increasing the export capability of small- and medium-sized companies starting export and support for entry into export markets, and refocusing the export plan programme (2005).
- Reducing the risks related to export activities for entrepreneurs by implementing export guarantees (2005).
- The introduction of a mentor program to counsel start-up businesses and thereby guarantee the sustainability of new companies (2005).
- Making state and private sector cooperation more effective with the goal of assisting the export of IT solutions based on e-State experiences (2006).

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<sup>18</sup> I.e. in addition to new technology based firms to support also traditional industries and non-innovative SMEs in order to help them to move into more knowledge-intensive areas and thus increase the value-added created.

<sup>19</sup> I. E. in addition to R&D-based technological innovation target more effectively non-technological innovation, e. g. design, organizational innovations etc.

<sup>20</sup> New concrete actions to be taken will be described in more detail under various measures in this chapter.

- Supporting the search, brokering, and implementation of new technologies (incl. from other countries) through the development of respective technology transfer units in order to promote increased productivity in both new companies and those already operating (2007).
- Strengthening Estonia's existing network of economic representatives and the broadening of representation of economic interests into new target countries (2007).
- Supporting the use of industrial design, in order to better and more effectively realize its hidden possibilities in making the products and services of companies more unique and capable of making a breakthrough (2007).

### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 4.4 Promoting an increase in added value and productivity, and supporting companies entering foreign markets and investments for the development of new technologies, products and services</b>		
The percentage of companies introducing new products and services or employing new technologies	36% in 2002 <sup>21</sup>	45%
The innovation expenditures of companies (percentage of turnover)	1.43% in 2000 (in 2000, the EU25 average 2.15%)	2%
Productivity per worker as a % of the EU 25 average	50.6% in 2004	60%
Employment in high-technology industry and services (% of total employment)	5.67% in 2003 (in 2003, the EU25 average 9.8%)	9%
Percentage of export of high-technology products as a % of total exports	9.4% in 2003 (in 2003, the EU25 average 17.8%)	18 %

<sup>21</sup> Source: Innovation activities in Estonian enterprises or Community Innovation Survey 3. In 2005 – CIS 4 (datas in every 3 years).

## **OBJECTIVE 5: The development of a business environment favourable to enterprise and entrepreneurship**

### **Measure 5.1: Promoting entrepreneurial culture with the goal of increasing enterprise activity and company innovation**

The total entrepreneurial activities index of the Estonian population is low, and therefore, the annual growth of new viable companies is very small (~6%). According to the household survey “The Entrepreneurship of Estonians” conducted by Estonian Institute of Economic Research only 9% of Estonians are potential entrepreneurs and only 5% of Estonians are classified as active in either start-up phase or managing a new business. The public awareness of enterprise and innovation is insufficient and thus the society limited support to entrepreneurship and initiative. In order to develop an environment favourable to entrepreneurship, it is necessary to increase people’s interest in entrepreneurship, to provide adequate information on different aspects of entrepreneurship, to disseminate best practices, and to value entrepreneurship as the driving force for the growth of Estonia’s economic development.

The *Estonian Enterprise Policy for 2007-2013* addresses the area of enterprise culture and entrepreneurship more than in the previous policy terms. The efforts planned in the field of enterprise culture are to be supported by those addressed for the establishing of better regulation.

#### **Activities**

- Increasing the entrepreneurship and innovation awareness in different groups of population, promotion of a knowledge-based society, and the promotion of the role of research and development by implementing programmes to increase the innovation awareness. Within the framework of the programme, training and informative activities will be carried out for different target groups: students and teachers, researchers, faculty members and university students, opinion-formers and the media, civil servants and policymakers, entrepreneurs, investors and company managers, and the general public (2005).
- The development of enterprises’ capacity for cooperation and their ability to get organised in order to strengthen the cooperation between Estonian enterprise organizations and their participation ability and to enliven cooperation between companies (2006).
- The addition of economic education, incl. adding business studies to the curricula of general education and vocational schools, and the development of supplementary enterprise-related training with the objective of increasing the number of enterprising people with the enterprise-related knowledge necessary for the establishment and operation of companies (2007).

#### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 5.1 Promoting a culture of enterprise with the goal of increasing enterprise activity and company innovation</b>		
The percentage of people who are planning	5% in 2004	9%

to establish or are starting up a company		
Number of companies per 1,000 residents	28 in 2004 <sup>22</sup>	32

### **Measure 5.2: Developing legislative framework favourable to enterprise and entrepreneurship**

Better regulation means making the legal framework coordinating the administrative activities of citizens, private businesses, non-profit organizations, and the state/local governments more effective. This means that the regulations established for the achievement of various objectives should not be accompanied by costs that outweigh the increased income generated by the achievement of these goals.

To make the legal framework more effective, it is necessary to consciously deal with its improvement. Working out new initiatives, it is very important to chart the income and expenditures resulting from the initiatives, evaluate the complexity of implementation procedures and relevant expenditures, and involve all relevant parties at as early stage as possible, in order to find the best solution considering interests of all parties.

Estonia currently lacks experience in analyzing and evaluating the impact of new draft legislation related to enterprise. The assessment of the effect of the regulatory impact and measurement of the administrative burden is especially important for small- and medium-sized companies that have fewer resources for fulfilling the requirements resulting from legislation as well as for communicating with the state. In order to avoid unfounded negative effects on companies resulting from legislation and to decrease excessive reporting obligations for small- and medium-sized companies, the *ex ante* analysis of the impact of legislation will be implemented for all legislation related to enterprise, and current legislation will be reviewed and simplified. In order to be able to operate smoothly and concentrate on their basic activities, the companies' management of public business with government agencies will be simplified and accelerated. The development of an impact assessment methodology is a complicated and long-term process. The first step is to develop methodology and test it by conducting specific field-related analyses; the main activities are focused on the standardization of the selection process for initiatives requiring impact analysis as well as the amendment and distribution of the methodology for measuring administrative burden. Thereafter, the impact analysis is expanded into other fields.

#### **Activities**

- Basic measurement of the administrative burden imposed on enterprises through the assessment of Value Added Tax (VAT) – the pilot study aims at testing the applicability of Standard Cost Model in Estonia, finding out the most burdensome procedures regarding administration of VAT obligations and assessing of costs for the enterprises resulting from fulfilment of the obligations (2005).
- Basic measurement of the administrative burden imposed on businesses through the assessment of wages and salaries reporting – the study aims at testing the applicability of Standard Cost Model in Estonia and assessing the costs for the enterprises resulting from wages and salaries reporting (2005).
- Charting the legislation influencing entrepreneurship by implementing an analysis of economic impact of the legislation related to entrepreneurship (2006).
- The development of a methodology and reporting form for evaluating the need for analysis uniform economic impact and the preparation and development of a system for the simplification of legislation in order to reduce the negative impact resulting from legislation and the administrative expenses to entrepreneurs (2006).

<sup>22</sup> Estonian Tax and Customs Board

- Simplifying communication between enterprises and government by creating single contact points, that enable the implementation of all the procedures needed for the establishment and authorisation of companies. In addition to single contact points, electronic tools for the establishment and authorisation of companies will be elaborated (2008).
- Simplifying the legal procedures by improving businesses access to notary services and making mandatory registers more available and improving the quality of their services (2006).

### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 5.2 Creating legal environment that promotes entrepreneurship</b>		
Maximum number of days for creating and licensing of a new enterprise	45-60 in 2005	25

### **Measure 5.3: Developing infrastructure supportive to business competitiveness**

The primary assignment of a transport system is to ensure the access of people and business to the items they need for everyday activities. Therefore, an effective transport system is one of the important preconditions for economic development. An effective transport system means repaired roads, and a safe traffic control system with no traffic jams. It also assumes the effective operation of the economy, not the fast development of transport as a separate economic sector, but the minimization of transport costs at every level, including the avoidance of needless transport needs. This means a reduction in and distribution of the need for movement, as well as effective logistics. The main problems of transport infrastructure that can be highlighted are the optimization of the city network of public transport and insufficient development of transport infrastructure. As a result, the number of public transport users has decreased and the use of cars has increased.

The Transport Sector Development Plan for 2006-2013 and the Public Transport Programme for 2006-2013 give new vision for regulating and development of transport system. Functioning of international transport connections is one of the factors that influence the competitiveness. The complete development of transport corridors belonging to the TEN –T networks, by creating conditions for optimal utilization of investments made, is considered important. Sustainable development of airports and harbours is essential for international passenger transport. By domestic development purposes, the attention is paid to investments in road safety, connections with islands, and increasing the thrift in transport sector. One of the key-activities hereby is the improvement of organisation and quality of the public transport system. It is also important to stop the worsening of the road conditions of highways and sideways.

Today, one of the important preconditions for improving the competitiveness is the existence of IT infrastructure, information society services and the broad distribution of fast communications is the basis of increasing productivity, of implementing new flexible forms of work, and the creation of new jobs. Public interest in the availability of fast Internet connections is primarily related to the need to reduce the digital gap in the society and with the need to increase the effectiveness of functioning of the society. Fast Internet connections help to bring public and private sector services to the consumers and to create new jobs. Fast Internet connections also allow for the existence of flexible forms of work and help to reduce the society's transportation needs and expenditures. It is also possible to significantly reduce regional inequality and in the long-term reduce development differences.

Creating a well-functioning information society is the long-term goal of the Information technology action plan 2006-2013. A better coordination of public information systems will give a new impetus to the development of e-State – the better integrated solutions will help to achieve abovementioned objective, guaranteeing at the same time a more effective use of resources and considerably diminishing the time necessary for the implementation of IT development projects.

#### **Activities**

- The development of infrastructure for research, science-and technology parks, and industrial parks in order to create growth platforms for new companies with a great growth potential (2005).
- The development of a spatial planning system in a form, which allows the development of transport, housing, enterprises, and the environment to be treated at the national and local level as a whole (2007).
- The development of public transport infrastructure by investing in rail and electric transport and creating advantages for public transport in road traffic that will help to make the transport system more effective and economical (2007).
- The development of information technology systems to make communication with state institutions more effective, the introduction of conducting business digitally and e-services in the entire public sector, and reinforcing it with widespread informative and training activities (2006).
- Ensuring the availability of fast Internet connections throughout Estonia that would guarantee all people the possibility to create and use e-services (2007).
- Increasing the awareness of IT-security and intensification of cooperation between sectors to guarantee the confidence between different parties who communicate via virtual environment.

#### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 5.3 The development of infrastructure that promotes an increase of competitiveness</b>		
Percentage of public transport users	29.2% in 2004	30%
Company satisfaction with public e-services	75% in 2004	80%

#### **Measure 5.4: Ensuring the security of electricity supply of the state and the effective functioning of energy market**

Estonia must be capable of constantly satisfying its power capacity needs with domestic producers, taking into account the opportunities resulting from the trade in electricity. The energy sector is one of the main environmental polluters in Estonia. The approaching opening of the electricity market will thoroughly change the functioning of the electricity market. For the replacement of the capacity based on aging technology with new, a regulatory environment promoting investments, which takes into account the opportunities and risks resulting from cross-border electricity trade, must be ensured. In order to guarantee supply, it is also important to create conditions for the modernization of the energy network.

Simultaneously with bringing new generation capacity on line in large-scale power production, attention needs to be paid to small-scale power generation and local needs. The effectiveness, reliability, quality of the heating supply in smaller settlements is problematic. To effectively manage the growth in energy consumption, state attention is needed for reorientation from

questions related to the production and distribution of energy to the energy savings of home and industrial end consumers.

The long-term national action plan for fuel and energy sector until 2015 was adopted by Parliament in December 2004. According to the Plan, state shall create conditions for smooth development of fuel and energy sector, according to the long-term consumption and environmental objectives.

#### **Activities**

- The construction of an Estonian-Finnish electrical cable (2006).
- The development of energy trade rules together with neighbouring countries (2006-2007).
- The modernization and development of the transmission network to increase the security of supply and reduce energy losses (2006-2007).
- The opening up of at least 35% of Estonian electricity market (2008).

#### **Measure 5.5: Making state monitoring more effective in order to ensure fair competition, quality and safety**

With an increase in competition, production efficiency increases, and the necessary consumer goods achieve a better price and quality ratio. While keeping the interference level of the state in business as low as possible, it is necessary to constantly monitor different branches of economy to guarantee equal competitive conditions for entrepreneurs. In fields that are traditionally regulated, such as telecommunications, power engineering, and railway transport, closer cooperation is necessary between competition institutions and market regulators, in order to achieve the best protection of the economic interests of consumers.

#### **Activities**

- Making the information exchange and cooperation of monitoring institutions more effective and integrating different existing information systems used for monitoring activities. To achieve this, analysis of the existing systems has been initiated, and based on the result a new information system will be developed that will ensure complete information exchange between all monitoring institutions (2006).
- The start up of pre-emptive activities related to quality and safety. To achieve this, training on safety-related legislation and informational campaigns directed at entrepreneurs and consumers will be carried out, and a statistical database will be developed in order to evaluate the various safety factors and thereby create clearer foundations for planning monitoring resources (2006).
- The implementation of a pro-active competition policy through sector analysis and increasing the business people's awareness of competition law. The data collected during sector analysis will be used to make proposals for the improvement of the legal framework and the updating of competition policy. Counselling and informing entrepreneurs helps to achieve the pre-emptive goal of monitoring. (2007).

## **OBJECTIVE 6: Strengthen the synergy between environmental protection and growth**

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A precondition for economic growth and continued developmental opportunities is the preservation of a quality living environment, which in turn is a central factor for well-being. The importance of preserving the natural environment is emphasized by the fact that nature can be treated simultaneously as a value as well as an essential development resource of the society.

The aim is to avoid increasing the pollution load while achieving economic growth. Increasing the administrative capacity, developing the environmental infrastructure (by preparing and implementing water and waste management plans), the application of new technologies, and the elimination of past pollution will reduce the pressure on the environment and ensure the preservation of biological diversity.

Reduction of environmental pollution and sustainable use of natural resources is a precondition for the optimization of company expenditures and reduction in the need for raw materials as well as for ensuring the preservation of the environmental quality and biodiversity. In order to achieve this, the state will contribute to the increase of environmental awareness among entrepreneurs and the public (especially schoolchildren) by employing structural funds and state budgetary resources. Increasing environmental awareness and preservation of biodiversity also promotes the development of tourism and thereby enables to create new jobs in the services sector.

Developing infrastructure and eliminating past pollution supports regional and enterprise development and allows for the creation of new jobs.

### **Measure 6.1: Increasing environmental awareness**

#### **Activities**

- Effective implementation of environmental management in companies and the support and stimulation of voluntary financing of environmental protection measures (e.g. the introduction of environmental management systems in companies, pollution, charge substitution agreements), by using active informational measures, their partial co-financing and state aid schemes (2005-2007).
- Promotion of the use of green public procurements, including the respective adaptation and implementation of the legal framework in both the public sector and companies in order to achieve the introduction of environmentally friendly solutions (2006).
- Ensuring the preservation of biodiversity through conservation activities with the aim of ensuring the protection of species and habitats (incl. establishment of the Natura 2000 network and securing of favourable conservation status); by reforming nature conservation administration; by developing a conservation development plan; and by initiating its implementation, guaranteeing among other things the state co-financing of nature conservation measures with the objective of diversifying rural live and offering alternative employment opportunities, and promoting nature tourism (2006).

**Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 6.1 Increasing environmental awareness</b>		
The number of companies having received environmental management system (ISO 14,000, EMAS) certificates	150 ISO 14,000 and 0 EMAS in 2003 <sup>23</sup>	250 ISO 14,000 and 25 EMAS
The state of endangered species and habitat types <sup>24</sup> (abundance of I and II category protected species <sup>25</sup> , Annex I of Habitat Directive on the protection of habitat types <sup>26</sup> )	The situation has not worsened	In 2003, the situation is good

**Measure 6.2: Reducing the pollution load and ensuring sustainable use of natural resources****Activities**

- Development of the Estonian Environmental Technology Development Plan together with the compilation and implementation of the national ETAP (*Environmental Technology Action Plan*) Road Map, via identification of the important technologies for the improvement of Estonia's environmental situation, developing recommendations for offering support measures to scientific institutions and companies to motivate them to develop or introduce, test or implement the necessary technologies, and thereby create a national cooperation network (2005).
- Supporting the development of environmental infrastructure and the elimination of past pollution, by development of water and waste management plans, and initiating and co-financing the infrastructure construction projects and reduction of past pollution (2005–2007).
- Promotion of sustainable energy production through the implementation and updating of the respective specific programmes (incl. planning of measures to increase the energy efficiency of buildings and support for the related activities) (2005–2007).
- By increasing the efficiency of the use of non-renewable natural resources (incl. increasing the efficiency of oil shale use) making energy production more environmentally friendly and promoting sustainable use of mineral construction materials, by initiating and co-financing the performing of the respective research activities and implementing the related state aid schemes (2005–2007).

**Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
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<sup>23</sup> Source: Certification centre.

<sup>24</sup> The state of endangered species and habitat types according to the Nature Protection Act.

<sup>25</sup> Source: Estonian Natura 2000 database: nature protection department of the Ministry of Environment; the abundance of I and II category protected species is evaluated every 5 years, for some species more often, the abundance of the II category protected species is evaluated within different timeframe for different categories.

<sup>26</sup> Source: Ministry of Environment, Information and Technology Centre; Estonian Nature Information System EELIS: [www.eelis.ee](http://www.eelis.ee) (data collection is annual).

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 6.2 Reducing the pollution load and ensuring the sustainable use of natural resources</b>		
The status of the evaluated water bodies of is good.	In 2003, of the evaluated water bodies, 60% are in good state <sup>27</sup>	Of the evaluated water bodies, 65% are in good state
The collection and proper treatment of sewage in settlements with over 2,000 population equivalents (% of settlements)	70% <sup>28</sup> in 2003	80%
The supply of the population with quality drinking water (% of the population)	65% in 2003 <sup>29</sup>	70%
Waste treatment according to internationally recognized environmental and health standards (% of waste)	25% in 2003 <sup>30</sup>	100%
The closing and remediation of landfills not meeting environmental standards, incl. industrial waste dumps (% of dumps)	50% in 2003	100%
The relative importance of renewable energy sources in electrical energy being produced as a % of gross consumption	0.1% in 2003 <sup>31</sup>	2.5%

<sup>27</sup> Source: Ministry of Environment, Information and Technology Centre

<sup>28</sup> Source: Ministry of Environment, Information and Technology Centre

<sup>29</sup> Source: Health Protection Inspectorate's database and report (annual datas)

<sup>30</sup> Source: Ministry of Environment, Information and Technology Centre

<sup>31</sup> Source: Ministry of Environment

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## **PART 3: THE LABOUR MARKET AND EMPLOYMENT**

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Estonian labour market is about to emerge from the phase where the main obstacle to higher employment was the shortage of jobs. Starting from mid-2000, the jobless growth that dominated in the 1990s was replaced by a steady increase in employment. By 2004, employment rate had reached 63% i.e 573.3 people aged 15–64 were employed. This indicates that a significant progress has been made over the last 5 years. Unemployment trend has also been favourable in 2004, unemployment rate decreased to 9,2% achieving the lowest level in last seven years.

Against the historical background, the latest developments in the labour market have been encouraging. Nevertheless, it is important to put our results into an international perspective. The European Union has set three main targets related to the labour market: by 2010, the member states must take all necessary measures to increase the employment rate to 70%, the employment rate of women to 60% and the employment rate of older workers (55 to 64) to 50%. Estonia has already achieved the objectives regarding women and older workers. The main reason behind the positive developments in the labour market has been rapid economic growth.

At the same time, the aforementioned is not meant to suggest that all problems related to the labour market are now solved. In addition to the growth of labour demand rapid increase in the employment rate also requires activation of the labour supply. Otherwise, the obstacle for increased employment will not be the shortage of jobs, but a lack of workers with appropriate qualifications and motivation.

Employment growth has not been sufficient for achieving the overall EU employment targets. Despite positive developments, unemployment rate continues to be high. A serious problem is structural unemployment. The education level, skill composition, and work experience of our labour force often does not correspond to the requirements of a rapidly changing labour market. The average educational level of the unemployed is significantly lower than that of the employed. Participation in life-long learning is also relatively low – according to the data from the 2004 EU Labour Force Survey, only 6.7% of the population aged 25–64 participated in some type of training in the previous four weeks. The corresponding figure in the European Union countries is 9.9% on average.

There are several disadvantaged groups for whom integration into the labour market is very difficult due to various reasons. Several risk groups could be highlighted, for which integration into the labour market is obstructed for various reasons. Above all, young people and the long-term unemployed should be highlighted. The youth unemployment rate, being very high since 1999, showed slight decrease in 2004, but stands still at 21%. The long-term unemployed constitute 52% of all the unemployed (or 4.8% of the workforce). Number of very long-term unemployed (job searches of over 24 months) has increased, especially among men. In 2004, almost 2/3 of the long-term unemployed had looked for a job over two years. Due to persisting long-term unemployment, Estonia has high number of discouraged workers (almost 18,000) who would like to work but have given up looking for a job.

In response to the shortcomings mentioned above, one of the main priorities of the government in the next few years is to increase qualification of labour, including providing people with better preparation for entering into the labour market, as well as supporting the regular accumulation

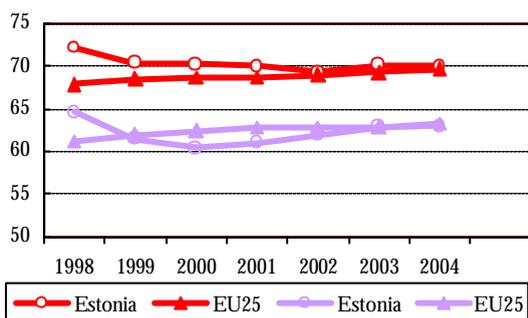
and renewal of skills by providing opportunities for individual development throughout their working lives. Another priority is to strengthen active labour market measures based on the needs of different risk groups and increase the flexibility of the labour market services, in order to bring risk groups into employment. In addition, it is necessary to increase flexibility and transparency of the labour market.

**Diagram 9**

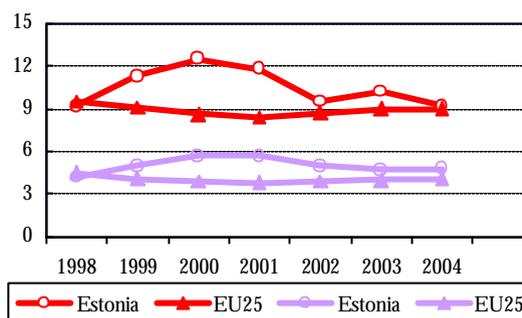
**Developments in the Estonian labour market**

(Percentage)

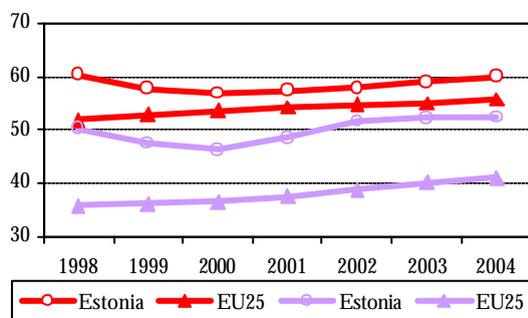
**A. Activity level and employment rate (15–64-year-olds)**



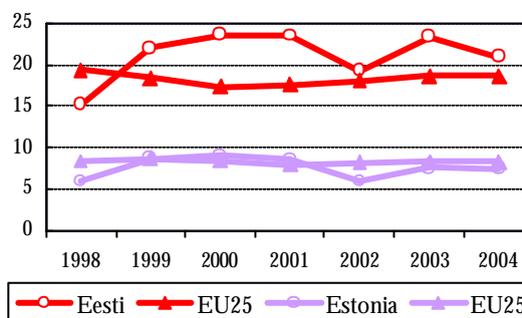
**B. Unemployment rate and long-term unemployment rate (15-74-year-olds)**



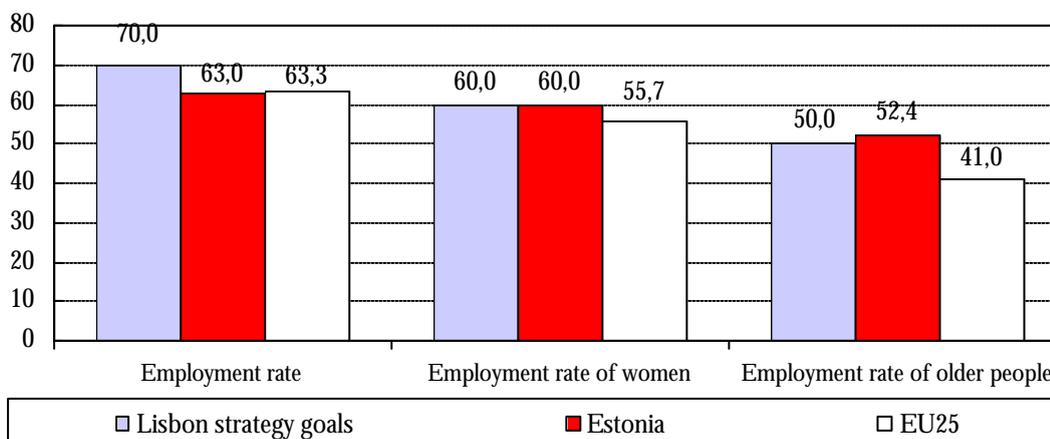
**C. Employment rate of women (15-64) and older workers (55-64)**

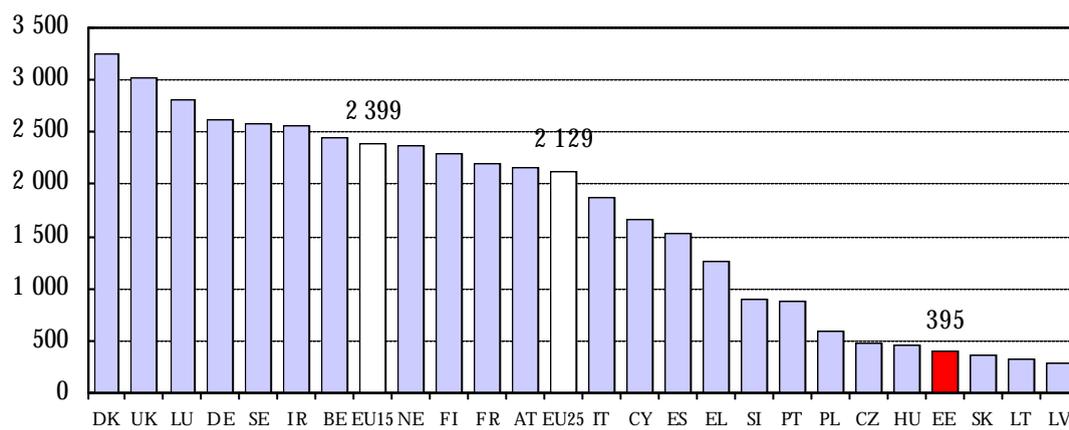


**D. Unemployment rate of young people and the share of youth unemployment in the age group 15–24**



**E. Estonia's and EU average employment rate compared to the Lisbon goals (2004)**



**F. Average monthly income in 2002 (in euro's)**

Sources: Eusostat, Statistical Office of Estonia, Ministry of Finance.

## **OBJECTIVE 7: Improve the quality of labour force**

### **Measure 7.1: Improving flexibility and effectiveness of formal education with special emphasis on vocational education**

Higher quality labour directly influences the growth of the gross domestic product (GDP) and allows employers to deal with offering higher added value products and services. In order to guarantee better conformity of labour qualifications with both short and long terms needs of employers, effectiveness of the Estonian educational system (both formal education, as well as supplementary training and retraining) should be increased – by modernizing the infrastructure of educational institutions, by creating flexible learning opportunities and possibilities to move between different branches of educational system and at the same time converging preferences of the students to the demands of the labour market. At the same time, serious attention must be paid to the complex development of technical and technological education and its integration with environmental education, involving hobby schools and youthwork, vocational education, professional higher education, and engineering studies.

#### **Activities**

- Increasing the share of primary school graduates that opt for vocational education by targeted planning of state-commissioned education (2009)<sup>32</sup>.
- The creation of state-commissioned study places at the higher education level: 50% for the secondary schools graduates and up to 10% for the vocational education graduates (on the basis of primary education), preferably in professional higher education level (2006–2008).
- To diversify the choices of basic and secondary education students, more vocational training opportunities will be created, including opening of vocation training classes (in cooperation with nearby vocational education institutions) (2008).
- The improvement of a support system (study, dormitory and transportation supports) in order to create opportunities for economically less-insured students to participate in vocational training (2005-2008).
- The enforcement of regulations in line with the European qualifications framework (2007), creating better opportunities for step-by-step movement between vocational and higher education curricula, with the main emphasis on the restructuring of upper secondary vocational training system. In addition, the creation of opportunities for the transition from vocational to higher education by the financing of supplementary general education studies of up to one year (2006).
- The popularization of the specialities of natural and exact sciences and technology among young people by offering innovative programs in general education schools and vocational education institutions, offering scholarships at the level of higher education, and supporting state hobby schools (e.g. technical houses, nature houses) and youth centres (2006–2008).

#### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 7.1 Increasing the flexibility and effectiveness of formal education by improving the collaboration of different educational levels</b>		
Share of primary school graduates acquiring vocational education	30% in 2004 <sup>33</sup>	38% <sup>34</sup>

<sup>32</sup> The Strategy for the Estonian Vocational Education System 2005–2008

Indicator	Current level	Projected level 2008
Number of secondary schools with vocational training availability	20 in 2004 <sup>35</sup>	30 <sup>36</sup>
The number of graduates in the fields of natural and exact sciences and technology per 1000 residents aged 20 to 29	6.6 in 2002 <sup>37</sup>	15% increase at 2010

## Measure 7.2: Improving quality of education

The increasing complexity of the society and economy in the 21<sup>st</sup> century faces educational system with great challenges. Knowledge-based economy assumes the acquisition of ever better education. This entails paying greater attention to general skills (incl. study skills), practical skills, implementation of knowledge, development of personal skills, and closer cooperation between different stakeholders in education. High quality education must guarantee readiness for life-long learning and respond primarily to the needs of the society, economy and labour market, but as well consider interests and needs of students. For improving the quality of education and thereby the quality of labour, development of curricula's, increased quality in the preparation of teachers and faculty members, development of supplementary training and sufficient investment to educational infrastructure should be highlighted as key success factors.

### Activities<sup>38</sup>

- The development and implementation of new basic and secondary education curricula (2007); compiling professional standards for teachers and introduction of a system for acquiring occupational qualifications (2006); development of an integrated counselling system and system for internal and external evaluation of schools; improving the financing model for general education (2006)<sup>39</sup>.
- Increasing the international competitiveness of higher education by greater specialization, infrastructure investments<sup>40</sup>, improvement of quality standards regulations, concentration of resources, licensing of educational institutions, and adopting legislation for joint degrees and diplomas (2006–2008).
- Fostering state initiatives to improve IT-related knowledge and skills as well as to develop respective infrastructure and learning environment in order to encourage the shift from basic skills development to the more intensive use of ICT in the learning process and provide support in coping with the challenges of a knowledge-based society (“The Learning Tiger” for general education and vocational schools (2006–2009), “Tiger University+” (2006–2008)).
- Improving the quality of the learning environment in vocational schools (rooms, study equipment) (2010).
- The development and implementation of a quality assurance system (2007) and preparation and supplementary training systems for vocational teachers (2005–2008)<sup>41</sup> in order to improve the quality of vocational education. Better organization and update of

<sup>33</sup> Source: Estonian Ministry of Education and Science, students register

<sup>34</sup> *The Strategy for Estonian Vocational Education System 2005–2008*

<sup>35</sup> Source: Estonian Ministry of Education and Science

<sup>36</sup> *The Strategy for Estonian Vocational Education System 2005–2008*

<sup>37</sup> Source: Estonian Ministry of Education and Science

<sup>38</sup> Activities highlighted for vocational learning development are based on *the Strategy for Estonian Vocational Education System 2005–2008*. In current action plan only priority measures for improving the quality of labour are highlighted.

<sup>39</sup> *The Strategy for the General Education System 2006–2009 (draft)*

<sup>40</sup> *The Strategic Principles of Modernising Infrastructure for Academic Higher Education, Science and Innovation*, approved by the Government on August 19, 2004

<sup>41</sup> European Social Fund project coordinated by the National Exam and Qualification Centre

the curriculum system in vocational education (2008) and preparation of a package of measures necessary for the implementation of the reforms (legislative package, vocational education standards, professional standards, state curricula).<sup>42</sup>

- Improving cooperation with employers/entrepreneurs and educational institutions in order to increase the learning quality, including making the apprentice's system more effective and increasing the role of employers in the councils of vocational education institutions (2007).<sup>43</sup>

### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level</b>
<b>Measure 7.2 Improving quality of education</b>		
Share of young people (20-24) with third level ISCED educations	83.3% in 2004 <sup>44</sup>	85% of 22-year-olds having secondary education in 2010
Share of people (30-34) with fifth and sixth level ISCED educations	28.6% in 2002 <sup>45</sup>	Stable
School drop-outs: third level of primary school	1.2% in 2002/03 <sup>46</sup>	1% in 2014
School drop-outs: secondary education level/10 <sup>th</sup> grade	2.97%/ 4.6% in 2002/03 <sup>47</sup>	Diminishing trend / 3% in 2014
School drop-outs: post-primary vocational education level	18% in 2002/03 <sup>48</sup>	Less than 10% in 2014 <sup>49</sup>
School drop-outs: upper secondary vocational education	21% in 2002/03 <sup>50</sup>	Less than 10% in 2014 <sup>51</sup>
Cost of a student place in vocational and general education	20200 in vocational education and 20400 in general education in 2003	Average cost of an educational place in vocational education is 1.5 times greater than general education at 2008 <sup>52</sup>

### **Measure 7.3: Increasing the employment readiness of young people by improving the effectiveness of youthwork<sup>53</sup>**

For successful entry into the labour market, good education and professional skills are not enough. Youth needs many other important qualities to be competitive i.e flexibility, independent thinking and the ability to react positively to changes in the life and work environment. To prevent getting caught in the “unemployed and inexperienced trap” it is important to acquire knowledge and skills in fields usually not covered by formal education: the social competence and practical work experiences in changing work conditions. Also important is

<sup>42</sup> *The Strategy for the Estonian Vocational Education System 2005–2008*, clause 4 p 6

<sup>43</sup> Draft legislation has been prepared for increasing the role of employers in school councils and making apprentice's system more effective. Law will presumably come into force on 1<sup>st</sup> of January, 2006.

<sup>44</sup> Source: EUROSTAT

<sup>45</sup> Source: EUROSTAT

<sup>46</sup> Source: Estonian Ministry of Education and Science, students register

<sup>47</sup> Source: Estonian Ministry of Education and Science, students register

<sup>48</sup> Source: Estonian Ministry of Education and Science, students register

<sup>49</sup> *The Strategy for the Estonian Vocational Educational System 2005–2008*

<sup>50</sup> Source: Estonian Ministry of Education and Science, students register

<sup>51</sup> *The Strategy for the Estonian Vocational Educational System 2005–2008*

<sup>52</sup> *The Strategy for the Estonian Vocational Educational System 2005–2008*, clause 4 p 2; Currently, the cost of a student place in general education and vocational education is practically even.

<sup>53</sup> Activities highlighted for youthwork development are based on *the Strategy of Youthwork and Youth Policy 2006-2013 (draft)*. In current action plan only priority measures for improving youth employment are highlighted.

the prevention or lessening impact of the social rejection of young people who have encountered difficulties in the labour market.

Youthwork offers many opportunities and methods for informal learning, whereby needed skills for coping in the labour market can be acquired and developed. To improve the quality of youthwork, it is important to increase the participation of youth in the decision-making processes and improve the qualifications of youth workers developing cooperation networks respectively.

### **Activities**

- The involvement of youth participative bodies and youth representative bodies in youth-related decision-making regarding education, employment, health, culture and social affairs, and thereby creating the respective consultation schemes at the state (I stage) and local level (II stage) (2006–2008).
- The improvement of the quality of youthwork by implementing professional standards (2006) and a quality evaluation system (2008) for youth workers.
- The strengthening of youthwork institutions and youthwork networks by fostering the programs for open youthcentres, information and counselling centres and specialty schools (2006-2008) and improving cooperation of stakeholders incl. supporting cooperation projects with schools and employers in local level (2006–2007).

### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 7.3 Increasing the employment readiness of young people by improving the effectiveness of youthwork</b>		
Involvement of youth (7-26) in youthwork	42% in 2005 <sup>54</sup>	60%
Participation of youth in youth institutions	3% in 2005 <sup>55</sup>	5%
The number of youthwork institutions	About 420 in 2005 <sup>56</sup>	500
Youth bodies in all counties and larger towns	5 in 2005 <sup>57</sup>	20

### **Measure 7.4: Developing a supplementary training and re-education system in line with the principles of lifelong learning**

For being competitive in the labour market throughout the life-cycle, skills and knowledge acquired at vocational or higher education is not sufficient. Dealing constantly with improving individual qualification's and openness for acquiring a new profession has become a key factor of competitiveness. Hereby, the task of the state is to create sufficient opportunities for employees for ongoing professional improvement and to assist in guaranteeing the quality of provided education. Therefore, working out a framework for the financing of lifelong learning has vital importance in Estonia.

### **Activities**

- Creation of better opportunities for supplementary training and re-education for both unemployed and employed (2006-2008).

<sup>54</sup> Estonian Ministry of Education and Science

<sup>55</sup> Estonian Ministry of Education and Science

<sup>56</sup> Estonian Ministry of Education and Science

<sup>57</sup> Estonian Ministry of Education and Science

- The development of a quality assurance system for adult education, incl. the training of trainers in order to insure a sense of security for both teachers and students regarding the quality of the training (2007).
- The development of a financing system for adult education in order to promote access to education for all adults and improve development of qualifications and acquisition of new qualifications, in order to guarantee the competitiveness of Estonian labour (2006).
- The reorganization of the collection of statistics concerning adult education and approving priority fields of research, in order to guarantee solid base of analysis for future projections and development activities (2007).

### Indicators

Indicator	Current level	Projected level 2008
<b>Measure 7.4 Developing a supplementary training and re-education system in line with the principles of lifelong learning</b>		
Share of the adult population ( aged 25-64) participating in lifelong learning	6.7% in 2004 <sup>58</sup>	10% <sup>59</sup>

### **Measure 7.5: Developing vocational, career, and learning counselling**

The state cannot and should not plan a person's career, but can guide it through favouring selection of professions mostly needed in the labour market. The main task of the state is to guarantee availability of relevant information through counseling services for both placement study students as well as people with retraining needs. Currently, the vocational and career counseling system has many shortcomings hindering placement study students or job seekers to make measured career decisions in line with the demand in labour market. Therefore, more emphasis should be put on the development of vocational and career counseling aiming to guide better preferences of job seekers.

### Activities

- The development and implementation of a uniform profession and career counselling network (2007).
- The development of implementation principles of a nation-wide APEL (accreditation of prior experiential) system to attach more importance to previous training and work experience (2007).
- To foster a system of professional qualifications in order to increase flexibility of educational system and improve its conformity with the demand of labour market (2006–2008).
- To improve forecasting of long- and short-term labour market needs through introducing and implementing a system of sectoral needs analysis by working out respective methodology (2006) and introducing regular monitoring of the labour force needs of employers (2007).

<sup>58</sup> Source: Eurostat

<sup>59</sup> The Strategy for Lifelong Learning 2005-2008

## **OBJECTIVE 8: Increase in labour supply**

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### **Measure 8.1: Increasing employment through active labour market measures and supportive social services and benefits**

Unemployment in Estonia is predominantly structural. In other words, people whose qualification do not correspond to the labour market needs and who experience have serious problems with participating in the open labour market constitute a large risk group. Taking into account the high number of long-term unemployed (33200 in 2004) and the fact that the average educational level of the unemployed is significantly lower than that of the employed, it is inevitable that the situation requires immediate policy response. In recent years demand for skilled labour in Estonia has started to surpass the supply. It can be foreseen that in the near future the labour supply will become a factor seriously inhibiting employment. Bringing risk groups into employment has a great importance as it would also reduce pressure on the state budget resulting from the high payment of social benefits. Moreover, reducing social exclusion increases social cohesion and quality of life in general.

Bringing risk groups back to employment is a complicated task requiring tailor-made measures which take into account specific difficulties each particular group may encounter when entering to labour market. As for the risk groups, the problems of the youth unemployment (a youth unemployment rate was 21% in 2004) and high number of the long-term unemployed (share of long-term unemployed constituted 52.5% of all unemployed in 2004) should be particularly highlighted. Traditionally, the employment rate of people with disabilities has been low (26% in 2002). Unfortunately, number of unemployed involved in active labour market measures has been relatively modest in comparison with the total number of unemployed. In 2004 most frequently used measures were training and vocational counselling (6,968 and 7,877 unemployed respectively). Current situation is clearly not satisfactory, active labour market measures should be made available for greater share of unemployed.

Therefore, Estonia's employment policy will focus on combined usage of active labour market measures. Moreover, the focus will be on supplementary social services and benefits aimed at activating those excluded from the labour market. The main objectives are to broaden and diversify services, implement individual approach and case management as well as increase the quality and effectiveness of services. Special emphasis is given to provision of the labour market training for a larger number of unemployed, which could help to reduce structural unemployment. As a supportive measure, receiving benefits should be made conditional on active job search in order to motivate people to take up employment.

#### **Activities**

- Implementing labour market services based on case management networks through:
  - o Developing basic training programme of case management networks in the framework of the university level social work programmes (2005-2006).
  - o Developing and implementing supplementary training programmes on case management networks for the members of existing networks (2006).
  - o Launching regular provision of the labour market services based on the principles of case management networks (2006).
  - o Introducing the employers' consultant position at the public employment service system (PES) in order to improve cooperation with employers, (especially) to find and train labour that responds to the needs of the employers (2006).

- Developing and providing new labour market services to risk groups through:
  - o Introducing basic working skills training targeted mainly to the long-term unemployed (2005-2006).
  - o Developing (2005) and systematically implementing (2006) tailor-made services for people with disabilities (working place adaptation, provision of free usage of special aids, assistance at job interviews, using support person at work).
  - o Developing (2005) and systematically implementing (2006) work based training targeted to the youth.
- Reviewing and strengthening the national public employment service (incl. the introduction of effective budgetary control, creation of a results-based motivation system, training of staff) in order to ensure the provision of effective labour market policies (2005).
- Developing a monitoring and evaluation system of the labour market measures through
  - o Mapping of the risk groups in order to specify their needs concerning provision of labour market services (2005).
  - o Developing and implementing the labour policy information system in order to improve the quality of the labour policy management (2006).
  - o Developing the methodology for the *ex post* evaluation of labour market services and evaluation of customers satisfaction (*Phare Twinning Light project*) in order to improve the efficiency and quality of the labour market services (2006).
- Integrating labour market and social services required to support the labour market inclusion and employability through:
  - o Developing (2006) and implementing (2007) a vocational and occupational rehabilitation system for people with disabilities.
  - o Developing (2006) and implementing (2007) social services to assist people with disabilities to stay at the labour market (incl. personal assistants/support persons, providing special adjusted means of transportation for the people with disabilities, sheltered and supported work, etc.).
  - o Conducting training to social workers for dealing with discouraged and long-term unemployed (2005).
  - o Developing (2006) and implementing (2007) a social information system to improve data availability about unregistered unemployed and inactive people as well as to ensure concrete link between receiving social benefits and participating in active labour market or social measures.
- Improving the management of the social and labour market benefits in order to motivate people to go to work instead of living on benefits through:
  - o Providing transport allowances and health insurance to the participants at work based training and labour market training (2006).
  - o Increasing conditionality of subsistence and unemployment benefits on participation in active social measures and labour market measures (2006).
  - o Evaluating effectiveness of the social welfare system (survey *Analysis of the impact of Estonian tax system and social benefits on labour supply*) (2005).
- Diversifying and improving the accessibility of childcare services in order to facilitate moving back to employment, through:
  - o Developing the childcare system (2005).
  - o Business start-up counselling and training to childcare providers (2005).
  - o Creating a database on companies, self-employed persons and third sector organisations providing childcare services (2005-2006).
- Assessing the impact of the free movement of workers to the supply of labour, through:
  - o Making a proposal to the Statistical Office to improve statistics on immigration and emigration (2006).

- o Evaluating the impact of the free movement of labour in EU (and respective transition period) to the Estonian labour market aiming to assess the potential for work-related emigration (2006).
- o Analysing the needs for migrant workers and developing government positions regarding work-related immigration (2007).

### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 8.1 Increasing employment by providing active labour market measures and supportive social measures</b>		
Number of long-term unemployed	33,200 in 2004 <sup>60</sup>	27,700
Share of registered unemployed participating in active labour market measures	9.2% in 2004 <sup>61</sup>	35% in 2005-2007
Share of participants of training courses moving to employment	42.4% in 2004 <sup>62</sup>	65%
Employment rate of people with disabilities	26% in 2002 <sup>63</sup>	30%

### **Measure 8.2: Improving the health of the population and insuring better working environment**

Estonia annually loses 6–7% of its potential labour force due to the premature morbidity and disability. Healthy people are also more productive. In the light of Estonia's ageing population, special attention must be paid to the fact that the contribution of labour to the productivity growth/added value is more and more often hampered by the unhealthy lifestyle and deteriorating health of workers. The high number of working days lost due to accidents at work (total of 145,000 days in 2004) is also a cause for serious concern.

Since a considerable decrease in labour supply can be predicted within the next few years, it is important to take measures for maintaining and improving the quality of the existing labour force. In order to reduce the decline in the labour supply and to raise people's active life span, it is important to improve the availability of preventive health services, to promote healthy lifestyle and to ensure living environment supporting health and health protection. From a labour supply perspective, it is also important to reduce and prevent health risks at the workplace (with the active participation of employers and employees), which in addition to maintaining capacity also increases workers ability to stay in employment.

### **Activities**

- Reducing premature morbidity and mortality, including
  - o Promoting healthy lifestyle by implementing the Strategy for Preventing Cardiovascular Diseases (2005 - 2007).<sup>64</sup>

<sup>60</sup> Source: Statistical Office of Estonia

<sup>61</sup> Source: Estonian Labour Market Board

<sup>62</sup> Source: Estonian Labour Market Board

<sup>63</sup> Source: Statistical Office of Estonia

<sup>64</sup> *The Strategy for the Prevention of Cardiovascular Diseases 2005–2020*. Regulation no. 89 of the Government of the Republic dated February 14, 2005. (RTL, 01.03.2005, 24, 340)

- o Reducing the burden caused by the consumption of alcohol, tobacco and illegal drugs through increasing public awareness, limiting availability, helping addicts, and expanding tobacco-free environment.<sup>65</sup>
- o Enhancing HIV/AIDS prevention by implementing the Strategy of the HIV/AIDS Prevention (2006), improving the management of other communicable disease epidemics and increasing preparedness by establishing a monitoring system for communicable diseases updating the laboratory base with better diagnostic possibilities.
- o Reducing and preventing health hazards related to the living environment by reorganizing the health protection system (2006–2007).
- Improving the working environment through a more effective implementation of occupational safety requirements and developing the accident at work and occupational disease insurance system and a prevention system for accidents at work and occupational diseases (2005–2007).

### **Indicators**

<b>Indicator</b>	<b>Current level</b>	<b>Projected level 2008</b>
<b>Measure 8.2 Improving the health of the population and insuring better working conditions</b>		
Average living expectancy by gender	65 for men in 2002 <sup>66</sup> 77 for women in 2002 <sup>67</sup>	Men, 67 Women, 78
Lost working days due to work accidents	145,000 in 2004 <sup>68</sup>	137,000
Number of accidents at work resulting in death per 100,000 workers	5.7 in 2004 <sup>69</sup>	4.7

<sup>65</sup> *The Strategy for the Prevention of Narcotics Addiction until 2012*, Decision no. 16 of the Government of the Republic, dated 22<sup>nd</sup> of April, 2004.

<sup>66</sup> Source: Estonian Statistical Office

<sup>67</sup> Source: Estonian Statistical Office

<sup>68</sup> Source: Estonian Health Insurance Fund

<sup>69</sup> Source: Estonian Labour Inspectorate

## **OBJECTIVE 9: Increase in the flexibility of the labour market and modernisation of the labour relations**

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### **Measure 9.1: Increasing the flexibility of the labour market and ensuring modern and balanced labour relations**

In a market economy, exact prognosis of the commodity market development is not viable. The competitiveness of companies is influenced by their ability to coordinate fluctuations in the commodity market with labour demand. Therefore, the more flexible the labour relations are the easier it is for the entrepreneurs to adapt to changes in the commodity market. On the other hand, too liberal labour market can lead to the situation where employer's decision based on the short-term market fluctuations may, seriously hinder the well-being of the workers and diminishing the quality of the labour force as a whole in a long run. Sustainable policy for growth and jobs needs to be based on balanced approach to labour relations. Hereby, the *flexicurity* approach can be implemented combining well-being of workers and flexible labour relations through balancing relatively liberal labour market legislation with sufficient guarantees during the period of unemployment.

Important progress has been made during the recent years for improving the security of workers – namely the system of unemployment insurance benefits have been successfully implemented. At the same time, increasing flexibility of the labour legislation has been left aside. Currently the flexibility of the Estonian labour market is hindered by the relative rigidity of the labour legislation, in particular concerning the termination of the employment and the high redundancy costs for the employer. Also, shortcomings in regulations of rental work and a fairly small usage of flexible forms of work by both entrepreneurs and workers (partially due to the lack of the awareness) can be highlighted.

#### **Activities**

- Increasing flexibility of labour relations regulations, through:
  - o Introducing a new draft of the Employment Contract Act in order to simplify the entry into and termination of employment contract while also providing reasonable guarantees to workers (2007).
  - o Promoting flexible forms of work among employers and employees (2006–2007).
  - o Amending the Employees Representative Act in order to achieve better involvement of workers in the activities of companies (2006).
  - o Amending the Collective Labour Dispute Resolution Act in order to balance the freedom of workers' to organize and take action with the realization of freedom of enterprise (2005).
  - o Amending the Collective Agreement Act in order to broaden the implementation of the principle of the freedom of contract when signing collective agreements (2007).
  - o Developing principles for the regulation of temporary agency workers (2006).
  - o Developing and piloting methods for assessing the impact of legal regulations on labour relations<sup>70</sup> (2006).
  - o Defining and implementing the evaluation principles necessary for assessing the impact of new policies and legislation to the labour market (2007).

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<sup>70</sup> The Phare Twinning Light project has been launched to conduct the analysis on the basis of the Employment Contract Act.

- Promoting modern and balanced labour relations, including:
  - o Improving the cooperation between the Labour Inspectorate and other supervisory agencies with the aim to reduce the negative impact of competitive advantages caused by undeclared labour relations and work environment that does not meet the standards (2007).
  - o Developing the principles of preventive nature aimed at facilitating more balanced labour relations (2006).

### **Indicators**

<b>Indicator</b>	<b>Current level<sup>71</sup></b>	<b>Projected level 2008</b>
<b>Part 3 General indicators of employment policy</b>		
Employment rate (15-64)	63% in 2004 <sup>72</sup>	65.8% 67.2% in 2010 70% in 2014
Employment rate of women (15-64)	60% in 2004 <sup>73</sup>	63.3% 65% in 2010
Employment rate of older workers (55-64)	52.4% in 2004 <sup>74</sup>	54.8%
Share of youth unemployed in the respective age group (15-24)	7.5% in 2004 <sup>75</sup>	6.0%
Activity rate	69.5% in 2004 <sup>76</sup>	71.3%
Long-term unemployment rate	4.8% in 2004 <sup>77</sup>	4%

<sup>71</sup> Sources: Eurostat and Estonian Statistical Office

<sup>72</sup> Source: Eurostat

<sup>73</sup> Source: Eurostat

<sup>74</sup> Source: Eurostat

<sup>75</sup> Source: Eurostat

<sup>76</sup> Source: Statistical office of Estonia

<sup>77</sup> Source: Eurostat

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## **ANNEXES**

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## Appendix 1. Coherence of Integrated guidelines and Estonian National Action Plan

Guidelines	Estonia Activities
<p><b>Guideline n°1. To secure economic stability for sustainable growth,</b></p> <p>1. in line with the Stability and Growth Pact, Member States should respect their medium-term budgetary objectives. As long as this objective has not yet been achieved, they should take all the necessary corrective measures to achieve it. Member States should avoid pro-cyclical fiscal policies. Furthermore, it is necessary that those Member States having an excessive deficit take effective action in order to ensure a prompt correction of excessive deficits, and</p> <p>2. Member States posting current account deficits that risk being unsustainable should work towards correcting them by implementing structural reforms, boosting external competitiveness and, where appropriate, contributing to their correction via fiscal policies. See also integrated guideline “To contribute to a dynamic and well-functioning EMU” (n°6)</p>	<p>Measures 1.1 and 1.3</p> <p>Estonia is one of the few EU member states, which has already achieved a balanced or surplus fiscal position. Our goal is to maintain this status in the future (Measure 1.1).</p> <p>See Measure 1.3 for information on the reduction of the current account deficit.</p>
<p><b>Guideline n°2. To safeguard economic and fiscal sustainability as a basis for increased employment,</b> Member States should, in view of the projected costs of ageing populations,</p> <p>1. undertake a satisfactory pace of government debt reduction to strengthen public finances;</p> <p>2. reform and re-enforce pension, social insurance and health care systems to ensure that they are financially viable, socially adequate and accessible, and</p> <p>3. take measures to increase labour market participation and labour supply especially amongst women, young and older workers, and promote a lifecycle approach to work in order to increase hours worked in the economy. See also integrated guideline “Promote a lifecycle approach to work” (No 18, and 4, 19, 21).</p>	<p>Objective 2</p> <p>The Estonian government debt is one of the lowest in EU. With the balanced fiscal position of government sector it will decrease further in the future.</p> <p>Estonia has already implemented a 3-pillar pension system. Future activities are related to the increase in the retirement age, and regulating the special pension system.</p> <p>The measures related to labour market and labour supply are described in part 3.</p>
<p><b>Guideline n°3. To promote a growth-and employment-orientated and efficient allocation of resources,</b> Member States should, without prejudice to guidelines on economic stability and sustainability, redirect the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, adapt tax structures to strengthen growth potential, ensure that mechanisms are in place to assess the relationship between public spending and</p>	<p>Objective 3</p> <p>In the EU, Estonia is distinguished by high expenditures in educational sector, both - public and private investments. We plan to increase the expenditures in R&amp;D (Measure 3.2).</p> <p>Estonia will reduce the taxation of labour by reducing the income tax and increasing the taxation on consumption and exploitation of the environment</p>

<p>the achievement of policy objectives and ensure the overall coherence of reform packages. See also integrated guideline "To encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth" (n° 11).</p>	<p>(Measure 3.1).</p>
<p><b>Guideline n°4. To ensure that wage developments contribute to macroeconomic stability and growth</b> and to increase adaptability Member States should encourage the right framework conditions for wage-bargaining systems, while fully respecting the role of the social partners, with a view to promote nominal wage and labour cost developments consistent with price stability and the trend in productivity over the medium term, taking into account differences across skills and local labour market conditions. See also integrated guideline "Ensure employment-friendly labour cost developments and wage-setting mechanisms" (No 22)</p>	<p>According to the agreement between employers and labour unions, the increase in productivity will be taken into account at the bilateral talks about raising the minimum wage. This is based on the principle that the increase in the minimum wage should not exceed the increase in productivity, not to risk with a loss of jobs.</p>
<p><b>Guideline n°5. To promote greater coherence between macroeconomic, structural and employment policies,</b> Member States should pursue labour and product markets reforms that at the same time increases the growth potential and support the macroeconomic framework by increasing flexibility, factor mobility and adjustment capacity in labour and product markets in response to globalisation, technological advances, demand shift, and cyclical changes. In particular, Member States should renew impetus in tax and benefit reforms to improve incentives and to make work pay; increase adaptability of labour markets combining employment flexibility and security; and improve employability by investing in human capital. See also integrated guideline "Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of social partners" (No 21 and No 19).</p>	<p>Objectives 2 and 3 See Measure 3.1 for information on the reorganization of the tax system. See Measures 2.1 and 2.2 for information on the reform of the social insurance system. See Measure 3.2 for information on investments in human capital. See Objective 9 for information on increasing flexibility at the labour market.</p>
<p><b>Guideline n°6 To contribute to a dynamic and well-functioning EMU,</b> euro area Member States need to ensure better co-ordination of their economic and budgetary policies, in particular,</p> <ol style="list-style-type: none"> <li>1. pay particular attention to fiscal sustainability of their public finances in full compliance with the Stability and Growth Pact;</li> <li>2. contribute to a policy mix that supports economic recovery and is compatible with price stability, and thereby enhances confidence among business and consumers in the short run, while being compatible with long term sustainable growth;</li> </ol>	<p>This guideline is for countries in euro zone.</p>

<p>3. press forward with structural reforms that will increase euro area long-term potential growth and will improve its productivity, competitiveness and economic adjustment to asymmetric shocks, paying particular attention to employment policies;</p> <p>4. and 4. ensure that the euro area's influence in the global economic system is commensurate with its economic weight.</p>	
<p><b>Guideline n°7. To increase and improve investment in R&amp;D, in particular by private business,</b> the overall objective for 2010 of 3% of GDP is confirmed with an adequate split between private and public investment, Member States will define specific intermediate levels. Member States should further develop a mix of measures appropriate to foster R&amp;D, in particular business R&amp;D, through:</p> <ol style="list-style-type: none"> <li>1. improved framework conditions and ensuring that companies operate in a sufficiently competitive and attractive environment;</li> <li>2. more effective and efficient public expenditure on R&amp;D and developing PPPs;</li> <li>3. developing and strengthening centres of excellence of educational and research institutions in Member States, as well as creating new ones where appropriate, and improving the cooperation and transfer of technologies between public research institute and private enterprises;</li> <li>4. developing and making better use of incentives to leverage private R&amp;D;</li> <li>5. modernising the management of research institutions and universities; and</li> <li>6. ensuring a sufficient supply of qualified researchers by attracting more students into scientific, technical and engineering disciplines and enhancing the career development and the European, international as well as inter-sectoral mobility of researchers and development personnel.</li> </ol>	<p>Measures 4.1 and 4.2</p> <p>Increasing public R&amp;D investments, thereby directing the growth primarily to cover socio-economic priorities, increasing the number of researchers and engineers, guaranteeing infrastructure, improving the quality of research, and better cohesion with enterprise sector (Measure 4.1). Considering that Estonia lags behind the rest of Europe, increasing private sector R&amp;D expenditures is an extremely important priority for Estonia. Increasing investments to support R&amp;D of enterprises to improve cooperation between enterprises and universities (Measure 4.1) and to increase the mobility of researchers and specialists.</p> <p>For more effective and strategic use of R&amp;D money, the monitoring of developments will be introduced (Measure 4.1).</p>
<p><b>Guideline n°8. To facilitate all forms of innovation,</b> Member States should focus on:</p> <ol style="list-style-type: none"> <li>1. improvements in innovation support services, in particular for dissemination and technology transfer;</li> <li>2. the creation and development of innovation poles, networks and incubators bringing together universities, research institutions and enterprises, including at regional and local level, helping to bridge the technology gap between regions;</li> <li>3. the encouragement of cross-border knowledge transfer, including from foreign direct investment;</li> <li>4. encouraging public procurement of innovative products and services;</li> <li>5. better access to domestic and international finance, and</li> <li>6. efficient and affordable means to enforce intellectual property rights.</li> </ol>	<p>Measures 4.3 and 4.4</p> <p>Estonia will concentrate on developing comprehensive support measures that meet the needs of various innovative enterprises. The enterprise/incubation centres and technology transfer units at universities to support start-up and innovative companies will be developed (Measure 4.4). The support of process for increasing the productivity of enterprises will be started. The access of innovative enterprises to the capital necessary for rapid growth will be improved (Measure 4.3). The support for enterprises entering external markets will be enhanced (Measure 4.4).</p>

<p><b>Guideline n°9. To facilitate the spread and effective use of ICT and build a fully inclusive information society,</b> Member States should:</p> <ol style="list-style-type: none"> <li>1. encourage the widespread use of ICT in public services, SMEs and households;</li> <li>2. fix the necessary framework for the related changes in the organisation of work in the economy;</li> <li>3. promote a strong European industrial presence in the key segments of ICT;</li> <li>4. encourage the development of strong ICT and content industries, and well-functioning markets;</li> <li>5. ensure the security of networks and information, as well as convergence and interoperability in order to establish an information area without frontiers; and</li> <li>6. encourage the deployment of broad band networks, including for the poorly served regions, in order to develop the knowledge economy. <i>See also integrated guideline “Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners” (n°21)</i></li> </ol>	<p>Measure 5.3 Continuing the development and usage of IT possibilities for introducing simpler, faster and cheaper administration in public sector. Insuring the availability of fast Internet connections throughout Estonia that enables all people to create and use e-services. The increasing of awareness regarding information security and making inter-sector cooperation more effective in order to guarantee confidence between parties communicating in the virtual environment (Measure 5.3). (The development of ICT industry and its use for the creation of added value is covered to a great extent by the activities specified in Guideline 8.)</p>
<p><b>Guideline n°10. To strengthen the competitive advantages of its industrial base,</b> Europe needs a solid industrial fabric throughout its territory. The necessary pursuit of a modern and active industrial policy means strengthening the competitive advantages of the industrial base, including by contributing to attractive framework conditions for both manufacturing and services, while ensuring the complementarity of the action at national, transnational and European level. Member States should:</p> <ol style="list-style-type: none"> <li>1. start by identifying the added value and competitiveness factors in key industrial sectors, and addressing the challenges of globalisation, and</li> <li>2. also focus on the development of new technologies and markets. <ol style="list-style-type: none"> <li>a. This implies in particular commitment to promote new technological initiatives based on public-private partnerships and cooperation between Member States, that help tackle genuine market failures.</li> <li>b. This also implies the creation and development of networks of regional or local clusters across the EU with greater involvement of SMEs. <i>See also integrated guideline “Improve matching of labour market needs” (n°20)</i></li> </ol> </li> </ol>	<p>Measures 4.1 and 4.4 To identify and develop perspective clusters and industrial sectors, development monitoring will be introduced (Measure 4.1). The innovation audits to chart factors impeding the growth potential and development of enterprises will be implemented. Support for finding more efficient technologies and for using them in enterprises will be provided (Measure 4.4).</p>
<p><b>Guideline n°11. To encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth,</b> Member States should:</p> <ol style="list-style-type: none"> <li>1. give priority to energy efficiency and co-generation, the development of</li> </ol>	<p>Measures 6.1 and 6.2 Developing and using new technologies play an essential role in increasing economic growth and productivity. Promotion of green public procurements will further the development of new and environmentally friendly technologies</p>

<p>sustainable, including renewable, energies and the rapid spread of environmentally friendly and eco-efficient technologies,</p> <ol style="list-style-type: none"> <li>a) inside the internal market on the one hand particularly in transport and energy, <i>inter alia</i>, in order to reduce the vulnerability of the European economy to oil price variations, and</li> <li>b) towards the rest of the world on the other hand as a sector with a considerable export potential;</li> </ol> <p>2. promote the development of means of internalisation of external environmental costs and decoupling of economic growth from environmental degradations. The implementation of these priorities should be in line with existing Community legislation and with the actions and instruments proposed in the Environmental Technologies Action Plan (ETAP), <i>inter alia</i>, through,</p> <ol style="list-style-type: none"> <li>a) the use of market-based instruments,</li> <li>b) risk funds and R&amp;D funding,</li> <li>c) the promotion of sustainable production and consumption patterns including the greening of public procurement,</li> <li>d) paying a particular attention to SMEs, and</li> <li>e) a reform of subsidies that have considerable negative effects on the environment and are incompatible with sustainable development, with a view to eliminating them gradually.</li> </ol> <p>3. pursue the objective of halting the loss of biological diversity between now and 2010, in particular by incorporating this requirement into other policies, given the importance of biodiversity for certain economic sectors.</p> <p>4. continue to fight against climate change, while implementing the Kyoto targets in a cost-effective way, particularly in regard to SMEs. <i>See also integrated guideline "To promote a growth-and employment-orientated and efficient allocation of resources" (n°3)</i></p>	<p>(Measure 6.1). Promotion of energy conservation is a basis for the sustainable use of natural resources, while also helping to optimize energy expenditures of enterprises (Measure 6.2).</p>
<p><b>Guideline n°12. To extend and deepen the internal market</b>, Member States should:</p> <ol style="list-style-type: none"> <li>1. speed up the transposition of internal market directives;</li> <li>2. give priority to stricter and better enforcement of internal market legislation;</li> <li>3. eliminate remaining obstacles to cross-border activity;</li> <li>4. apply EU public procurement rules effectively;</li> <li>5. promote a fully operational internal market of services, while preserving the European social model, and</li> <li>6. accelerate financial market integration by a consistent and coherent implementation and enforcement of the Financial Services Action Plan. <i>See also integrated guideline "To improve matching of labour market needs" (n°20)</i></li> </ol>	<p>Measure 5.5 The speed of the transposition of directives has been high in Estonia. In one year, the transposition deficit has been reduced by almost 8%. In the third quarter of 2005, the deficit of transposition of internal market directives was 1.8%. Many important draft legal acts have been prepared by the government and Estonia has set a goal of reaching a deficit of no more than 1.5% by the next year. The implementation of the Financial Services Action Plan and the application of the EU public procurement regulations has been a priority of the Estonian government and it has progressed well. Estonia considers it important to guarantee fair competition by the state supervision.</p>

<p><b>Guideline n°13. To ensure open and competitive markets inside and outside Europe and to reap the benefits of globalisation,</b> Member States should give priority to:</p> <ol style="list-style-type: none"> <li>1. the removal of regulatory, trade and other barriers that unduly hinder competition;</li> <li>2. a more effective enforcement of competition policy;</li> <li>3. selective screening of markets and regulations by competition and regulatory authorities in order to identify and remove obstacles to competition and market entry;</li> <li>4. a reduction in State aid that distorts competition;</li> <li>5. in line with the upcoming Community Framework, a redeployment of aid in favour of support for certain horizontal objectives such as research, innovation and the optimisation of human capital and for well-identified market failures;</li> <li>6. the promotion of external openness, also in a multilateral context;</li> <li>7. full implementation of the agreed measures to open up the network industries to competition in order to ensure effective competition in European wide integrated markets. At the same time, the delivery, at affordable prices, of effective services of general economic interest has an important role to play in a competitive and dynamic economy.</li> </ol>	<p>Measure 5.5</p> <p>Estonia does not have any major problems in this field. The government has constantly paid much attention to guaranteeing the competition. It has implemented the policy not favouring state aid for enterprises. The planned activities are specified under Measure 5.5.</p>
<p><b>Guideline n°14. To create a more competitive business environment and encourage private initiative through better regulation,</b> Member States should:</p> <ol style="list-style-type: none"> <li>1. reduce the administrative burden that bears upon enterprises, particularly on SMEs and start-ups;</li> <li>2. improve the quality of existing and new regulations, while preserving their objectives, through a systematic and rigorous assessment of their economic, social (including health) and environmental impacts, while considering and making progress in measurement of the administrative burden associated with regulation, as well as the impact on competitiveness, including in relation to enforcement; and</li> <li>3. encourage enterprises in developing their corporate social responsibility.</li> </ol>	<p>Measure 5.2</p> <p>Estonia has not assessed the negative impact of administrative burden or legislation on enterprises. 42% of enterprises note negative impact proceeding from regulation. They consider legislation and red tape the greatest obstacle to their business activities.</p> <p>In order to reduce the administrative burden and negative impact of legislation on enterprises, different instruments are being worked out for assessing the administrative burden and reducing the negative impact of legislation (Measure 5.2). Both new and existing legislation is assessed.</p> <p>Excessive bureaucracy makes administrative management with government agencies more expensive and complicated. For concentration on their main activities there will be established a new single contact point for enterprises for communicating with government agencies (Measure 5.2).</p> <p>To improve the quality of elaboration of legal acts, a wider public dialogue will be initiated and interest groups will be involved in elaboration of regulation.</p> <p>The restrictions limiting the establishment and operation of enterprises providing</p>

<p><b>Guideline n°15. To promote a more entrepreneurial culture and create a supportive environment for SMEs,</b> Member States should:</p> <ol style="list-style-type: none"> <li>1. improve access to finance, in order to favour their creation and growth, in particular micro-loans and other forms of risk capital;</li> <li>2. strengthen economic incentives, including by simplifying tax systems and reducing non-wage labour costs;</li> <li>3. strengthen the innovative potential of SMEs, and</li> <li>4. provide relevant support services, like the creation of one-stop contact points and the stimulation of national support networks for enterprises, in order to favour their creation and growth in line with Small firms' Charter. In addition, Member States should reinforce entrepreneurship education and training for SMEs. They should also facilitate the transfer of ownership, modernise where necessary their bankruptcy laws, and improve their rescue and restructuring proceedings. See also integrated guidelines "To promote a growth- and employment-orientated and efficient allocation of resources (n°3) and "To facilitate all forms of innovation (n°8, n°23 and 24).</li> </ol>	<p>services will be decreased and their application procedures will be simplified.</p> <p>Measure 4.3</p> <p>Opinions of entrepreneurs regarding the availability of financial resources have improved in the last few years. If, until May of 2002, the availability of financial resources was the greatest obstacle to business activities for 34 % of enterprises, then in 2005, the percentage of such enterprises is 21% of all operating enterprises. The problem is more acute among new and small enterprises, which do not have enough knowledge for involving capital and there is no basis for assessing the financial capabilities of the enterprise. The problem is especially acute in new, rapidly growing enterprises.</p> <p>In order to improve the access of new and small enterprises to capital, their knowledge and skills in financial management and capital involvement will be improved. In order to offer risk capital to innovative enterprises in the preliminary phase, the Estonian Development Fund will be created (measure 4.3). In order to direct Estonian capital into Estonian business, and thereby increase their access to financial resources, a network of local investors will be developed and contacts between investors and companies requiring investment will be exchanged (Measure 4.3).</p> <p>The cost of providing information and making small loan transactions is disproportionately great and therefore the granting of small and micro loans is not economically practical for banks. At the same time, 41% of enterprises needing loans assess their capital needs at under 200,000 EEK (the needs of 96% of the SME-s do not exceed 5 million EEK). It requires reducing the information costs of financial institutions to make small volume loan capital available. That could be accomplished by creating corresponding information applications.</p> <p>From the studies on the initiative of the Estonian population it appears that the entrepreneurs starting their business should first apply to banks for getting financial resources and consultations. Therefore, cooperation between the private and public sector should be made more effective, to better apply the support measures and financial aid for start-up entrepreneurs.</p>
<p><b>Guideline n°16. To expand, improve and link up European infrastructure and complete priority cross-border projects</b> with the particular aim of achieving a greater integration of national markets within the enlarged EU. Member States should:</p> <ol style="list-style-type: none"> <li>1. develop adequate conditions for resource- efficient transport, energy and ICT</li> </ol>	<p>Measures 5.3 and 6.2</p> <p>Repairing main roads and the implementation of transport infrastructure modernisation programmes (Via Baltica and Tallinn–Narva corridor; Jõhvi–Tartu–Valga road; Tallinn–Tartu–Võru–Luhamaa road).</p> <p>Participation in the north-south 1,435 mm gauge railway line development</p>

<p>infrastructures – in priority, those included in the TEN networks - by complementing Community mechanisms, notably including in cross-border sections and peripheral regions, as an essential condition to achieve a successful opening up of the network industries to competition;</p> <p>2. consider the development of public-private partnerships, and</p> <p>3. consider the case for appropriate infrastructure pricing systems to ensure the efficient use of infrastructures and the development of a sustainable modal balance, emphasizing technology shift and innovation and taking due account of environmental costs and the impact on growth. See also integrated guideline "To facilitate the spread and effective use of ICT and build a fully inclusive information society (n°9).</p>	<p>project (Rail Baltica) .</p> <p>The development of a national public transport management structure to optimize line networks (Measure 5.3).</p> <p>Ensure national-wide access to fast Internet connection that enables everyone to create and use e-services (Measure 5.3).</p> <p>Promote energy conservation by the implementation and modernization of a relevant specific research programme (incl. propose actions for improving energy performance of buildings and supporting the preparation of these actions) (Measure 6.2).</p> <p>The introduction of mechanisms for the public sector to involve the private sector.</p>
<p><b>Guideline No.17: Implement employment policies aiming at achieving full employment, improving quality and productivity at work, and strengthening social and territorial cohesion.</b></p> <p>Policies should contribute to achieving an average employment rate for the European Union (EU) of 70% overall, of at least 60% for women and of 50% for older workers (55 to 64) by 2010, and to reduce unemployment and inactivity. Member States should consider setting national employment rate targets.</p>	<p>Objective 7 and Measure 4.2</p> <p>23% of Estonia's entrepreneurs consider that the knowledge and skills of their workers is the greatest obstacle to their business activities. The greatest obstacle to training activities is, however, the cost of training. To bring the knowledge and skills of workers into conformity with the real needs of companies in a rapidly changing economic environment, life-long learning will be promoted and training activities in companies supported (Measure 4.2, Goal 7). At the same time, awareness of population about entrepreneurship and innovation will be increased to promote entrepreneurship as an alternative to wage labour paid employment (Measure 5.1).</p>
<p><b>Guideline No.18: Promote a lifecycle approach to work</b> through:</p> <ul style="list-style-type: none"> <li>- a renewed endeavour to build employment pathways for young people and reduce youth unemployment, as called for in the European Youth Pact;</li> <li>- resolute action to increase female participation and reduce gender gaps in employment, unemployment and pay;</li> <li>- better reconciliation of work and private life and the provision of accessible and affordable childcare facilities and care for other dependants;</li> <li>- support to active ageing, including appropriate working conditions, improved (occupational) health status and adequate incentives to work and discourage early retirement;</li> <li>- modern social protection systems, including pensions and healthcare, ensuring their social adequacy, financial sustainability and responsiveness to changing needs, so as to support participation and better retention in employment and longer working lives.</li> </ul>	<p>Objectives 7, 8, 9</p> <p>The youth unemployment rate in Estonia is high (21% in 2004), therefore young people are considered to be a risk group in the labour market, for whom the main barrier to the entering the labour market is the insufficient training, or skill and demand mismatch and the lack of prior work experience. In terms of young people entering to the labour market an appropriate policy response is believed to be providing appropriate training in order to facilitate smoother entering into their working lives. This includes modernisation of the educational system and improving the quality of education, developing youth work and ensuring the access to vocational counselling (Goal 7). There is a new service designed for young people who encounter problems when entering to the labour market, namely work based training to gain work experience (measure 8.1).</p> <p>As far as the employment rate of women is concerned Estonia has achieved the Lisbon objective for 2010 (60% in 2004). Latter figure is also higher than the EU</p>

<p>See also integrated guideline “To safeguard economic and fiscal sustainability as a basis for increased employment” (No 2).</p>	<p>average (55.7% in 2004). At the same time, unlike many other EU countries the unemployment of women in Estonia is lower than that of men. The unemployment trend of women is declining – the rate of unemployment among women fell by 1.8 % between 2003 and 2004. Therefore, it can be said that the situation of women in general in the labour market is relatively good in comparison with other groups. Still, an important the Action Plan has paid attention to one factor that promotes the participation of women in the job market – the diversification of childcare possibilities and making childcare more flexible (Measure 8.1). The reduction of labour market segregation is primarily a matter of long term policy implementation. This should be facilitated by the strengthening of vocational and career counselling and the popularization of certain professions.</p> <p>The employment of older workers in Estonia exceeds the Lisbon objective (52.4% in 2004) and continues to rise. The employment of older workers is promoted by pension reform and rising of the retirement age. The continued employment of older people is also supported by the promotion of flexible forms of work (Measure 9.1), activities targeted at improving the health and working environment of the population (Measure 8.2) and the activities for the implementation of the principles of life-long learning (Measure 7.4).</p>
<p><b>Guideline No.19: Ensure inclusive labour markets, enhance work attractiveness, and make work pay for job-seekers, including disadvantaged people, and the inactive</b> through:</p> <ul style="list-style-type: none"> <li>- active and preventive labour market measures including early identification of needs, job search assistance, guidance and training as part of personalised action plans, provision of necessary social services to support the inclusion of those furthest away from the labour market and contribute to the eradication of poverty;</li> <li>- continual review of the incentives and disincentives resulting from the tax and benefit systems, including the management and conditionality of benefits and a significant reduction of high marginal effective tax rates, notably for those with low incomes, whilst ensuring adequate levels of social protection;</li> <li>- development of new sources of jobs in services to individuals and businesses, notably at local level.</li> </ul>	<p>Measure 8.1</p> <p>Bringing risk groups to the the employment is an important priority in the situation where the labour supply is shrinking. For that purpose providing more flexible active labour market services and developing new services for the primary risk groups is being planned. (Measure 8.1). Since a long-term unemployed constitute a large share of the total unemployed in Estonia (52% in 2004), the objective is to increase the supportive role of social measures (Measure 8.1). To prevent long-term unemployment and to motivate people to take up employment, a more direct link between participation in social measures and in active job measures is foreseen. (Measure 8.1).</p> <p>To evaluate the positive and negative impact of taxation and benefit systems to people’s willingness to take up employment, a study “<i>Analysis of the impact of Estonian tax system and social benefits on labour supply</i>” is being conducted (Measure 8.1).</p> <p>A realistic alternative to paid employment should be entrepreneurship which also contributes to job creation. The establishment of a company and starting up business, however, requires financial means, which are hard to obtain for the</p>

	unemployed and those who are least privileged. In order to increase entrepreneurial activity among all population groups, starting businesses under favourable conditions is being supported among the unemployed and those of least privileged.
<p><b>Guideline No.20: Improve matching of labour market needs</b> through:</p> <ul style="list-style-type: none"> <li>- the modernisation and strengthening of labour market institutions, notably employment services, also with a view to ensuring greater transparency of employment and training opportunities at national and European level;</li> <li>- removing obstacles to mobility for workers across Europe within the framework of the Treaties;</li> <li>- better anticipation of skill needs, labour market shortages and bottlenecks;</li> <li>- appropriate management of economic migration.</li> </ul>	<p>Measure 7.1, 7.4, 7.5 and 8.1</p> <p>It is planned to review the foundations and structure of the national public employment service system in order to enable the system's ability to implement active labour market policy. The provision of labour market services, based on case management networks is also planned (Measure 8.1). In order to make the public employment services more effective, the evaluation methods of the effectiveness of the labour market services provided will be strengthened . An important input for that will be gained from the implementation of the statistical information system about the public employment services (Measure 8.1). For a better match between demand and supply the employers' consultant position at the public employment service system (PES) is introduced (measure 8.1).</p> <p>Estonia is in favour of the open labour market within the EU. Estonia has not implemented any limitations on European Union citizens entering its labour market and calls upon the other member states to implement the principle of equal treatment on the European Union labour market. At the same time, Estonia is interested in holding negotiations with the countries that have enforced transition periods in order to avoid the further extension of transition periods and to potentially shorten them. The Plan of Action envisions the enforcement of regulations following the principles of a uniform European qualifications framework, which, would mean the removal of one of the main obstacles inhibiting the free movement of workers at present (Measure 7.1).</p> <p>In order to prevent the bottlenecks and skills mismatches, the long- and short-term forecasting of labour demands are carried out and a sectoral research system and regular monitoring of employers' labour needs is being introduced (Measure 7.5). The same objective is supported by the review of the educational system taking into account the need to meet the labour market requirements. (Measure 7.1), careers and vocational counselling (Measure 7.5), and the introduction of a supplementary and re-education system (Measure 7.4).</p> <p>For the appropriate management of economic migration, first of all the opinion regarding work-related immigration should be formed (measure 8.1). At the same time, the Estonia's potential for work-related emigration will be analyzed in order to evaluate the impact of the free movement of EU labour, and the related</p>

	transition period, on the Estonian market (measure 8.1).
<p><b>Guideline No.21: Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners,</b> through:</p> <ul style="list-style-type: none"> <li>- the adaptation of employment legislation, reviewing where necessary the different contractual and working time arrangements;</li> <li>- addressing the issue of undeclared work;</li> <li>- better anticipation and positive management of change, including economic restructuring, notably changes linked to trade opening, so as to minimise their social costs and facilitate adaptation;</li> <li>- the promotion and dissemination of innovative and adaptable forms of work organisation, with a view to improving quality and productivity at work, including health and safety;</li> <li>- support for transitions in occupational status, including training, self-employment, business creation and geographic mobility;</li> </ul> <p>See also integrated guideline “To promote greater coherence between macroeconomic, structural and employment policies” (No 5).</p>	<p>Measure 9.1</p> <p>Estonia’s labour laws are characterized by relative inflexibility, especially those concerning the termination of the employment contract. . The question of temporary agency workers is also insufficiently regulated. Therefore there is a need adapt the labour law in order to increase flexibility. In the Action Plan the following amendments to existing laws and introductions of new legislation are discussed: preparing a draft of the Employment Contract Act, amending Employees Representative Act and Collective Labour Dispute Resolution Act ., formulating the principles for the regulations on temporary agency workers, and developing the methods to evaluate the impact of the legal regulations on work relations (measure 9.1).</p> <p>The share of undeclared work in Estonia is relatively large (5% in 2002). In order to reduce this the Action Plan emphasises the need to improve the cooperation between the Labour Inspectorate and other supervisory institutions (measure 9.1) and developing the principles of preventive nature aimed at the reorganization of labour relations (measure 9.1).</p> <p>For the promotion and dissemination of innovative and flexible work organisation, it is planned to raise the awareness about flexible work forms and organization as well as promote the favourable attitudes among employers and employees (measure 9.1).</p>
<p><b>Guideline No.22: Ensure employment-friendly labour cost developments and wage-setting mechanisms</b> by:</p> <ul style="list-style-type: none"> <li>- encouraging social partners within their own areas of responsibility to set the right framework for wage bargaining in order to reflect productivity and labour market challenges at all relevant levels and to avoid gender pay gaps;</li> <li>- reviewing the impact on employment of non-wage labour costs and where appropriate adjust their structure and level, especially to reduce the tax burden on the low-paid</li> </ul> <p>See also integrated guideline “To ensure that wage developments contribute to macroeconomic stability and growth” (No 4).</p>	<p>Measure 9.1</p> <p>In Estonia, the Government annually confirms the national minimum wage according to the minimum wage agreement between social partners., Yet, the coverage with collective agreements at the branch level of the economy is relatively modest. The aim of the Collective Agreements Act is to create a legal framework which promotes greater involvement in collective bargaining especially at branch level. (measure 9.1).</p> <p>As to the adjustment of non-wage labour costs, the Action Plan deals with the possible reduction of redundancy costs in the new draft of the Employment Contracts Act. Currently the the redundancy costs in Estonia are relatively high, which inhibits the flexibility of the labour market (measure 9.1).</p>
<p><b>Guideline No.23: Expand and improve investment in human capital</b> through:</p>	<p>Objective 7</p> <p>During the next few years, the post-primary school distribution of educational</p>

<ul style="list-style-type: none"> <li>- inclusive education and training policies and action to facilitate significantly access to initial vocational, secondary and higher education, including apprenticeships and entrepreneurship training;</li> <li>- significantly reducing the number of early school leavers;</li> <li>- efficient lifelong learning strategies open to all in schools, businesses, public authorities and households according to European agreements, including appropriate incentives and cost-sharing mechanisms, with a view to enhancing participation in continuous and workplace training throughout the life-cycle, especially for the low-skilled and older workers.</li> </ul> <p>See also integrated guideline "To increase and improve investment in R&amp;D, in particular by private business' (No 7).</p>	<p>places is planned to have a trend that 40% of students will continue at vocational education institutions and 60% at upper secondary schools; at the higher education level, 50% of the state commissioned study places will be assigned to upper secondary school graduates and 10% to vocational secondary school graduates (measure 7.1).</p> <p>To reduce the drop-out rate, preventive measures will be implemented such as the further development of a counselling system (measure 7.3) and the creation of a support system for children requiring special education, the reduction of the number of students in general education school classes, changing grading to be more supportive of the students' development, the creation of possibilities for young people who have passed the age of compulsory school attendance without graduation to simultaneously acquire a primary education and vocational training (measure 7.2); starting in 2007, all children should be involved in pre-school at least one year before starting school, as well as individualized curricula, and "Toots" classes for children with behavioural problems.</p> <p>A strategy project for life-long learning has been prepared, which will be forwarded to the Government of the Republic in 2006 (measure 7.4).</p> <p>Training support has been implemented, but training has not yet become self-evident for Estonia's small- and medium-sized enterprises as a part of developing competitiveness. The percentage of companies that have trained their workers has only increased a few percentage points in the last few years (2002–2004, 2%).</p> <p>In order to activate training activity in companies, the training support program will be reviewed and a training plan program will be implemented. At the same time, the general public and various target groups will be informed and educated about the fields of enterprise and innovation.</p>
<p><b>Guideline No.24: Adapt education and training systems in response to new competence requirements</b> through:</p> <ul style="list-style-type: none"> <li>- raising and ensuring the attractiveness, openness and quality standards of education and training, broadening the supply of education and training opportunities and ensuring flexible learning pathways and enlarging possibilities for mobility for students and trainees;</li> <li>- easing and diversifying access for all to education and training and to knowledge by means of working time organisation, family support services, vocational guidance and, if appropriate, new forms of cost-sharing;</li> <li>- responding to new occupational needs, key competences and future skill requirements by improving the definition and transparency of qualifications,</li> </ul>	<p>Measure 7.1 and 7.2</p> <p>Estonia has implemented the activities that accompanied the signing of the Bologna Declaration (transition to a system of 3+2 curricula, completed legislation for issuing diploma supplements, ratified the Lisbon Convention that regulates the recognition of diplomas, uniform principles and policies for insuring quality, etc.) and work continues on the activities approved in the communiqué issued in Bergen in May of 2005 (Measure 7.2). Similarly, the activities specified in the Copenhagen process have been reflected in the action plan for vocational education in 2005–2008 (increasing the attractiveness of vocational education, application of a quality assurance system, start up of a national Europass centre, etc.) (Measure 7.2) Work on the comparability of work qualifications is</p>

<p>their effective recognition and the validation of non-formal and informal learning.</p>	<p>continuing within the frame of the European qualification framework (Measure 7.1). Entrepreneurial education is currently elective and it is missing from curricula. Adding entrepreneurial education to the curricula of secondary schools, vocational schools and as a elective in higher educations schools.</p>
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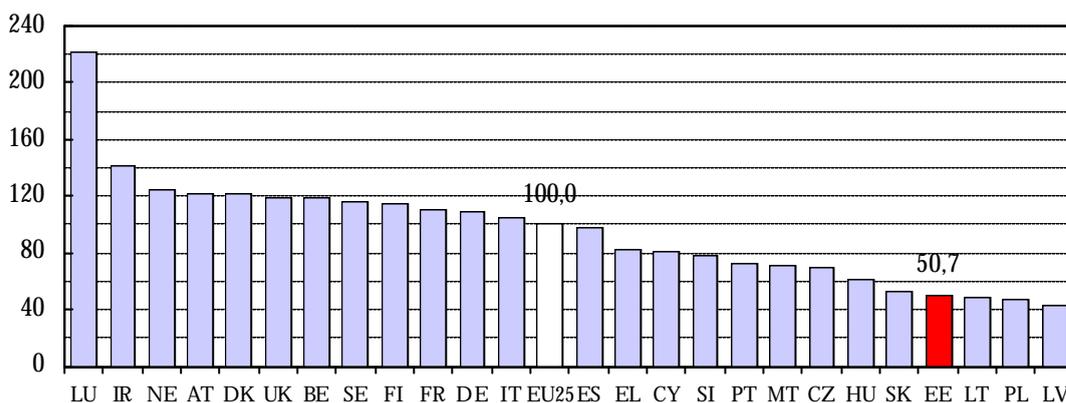
## Appendix 2. Comparison of Estonia and ther EU member states based on structural indicators

**Diagram 10**

### General economic background

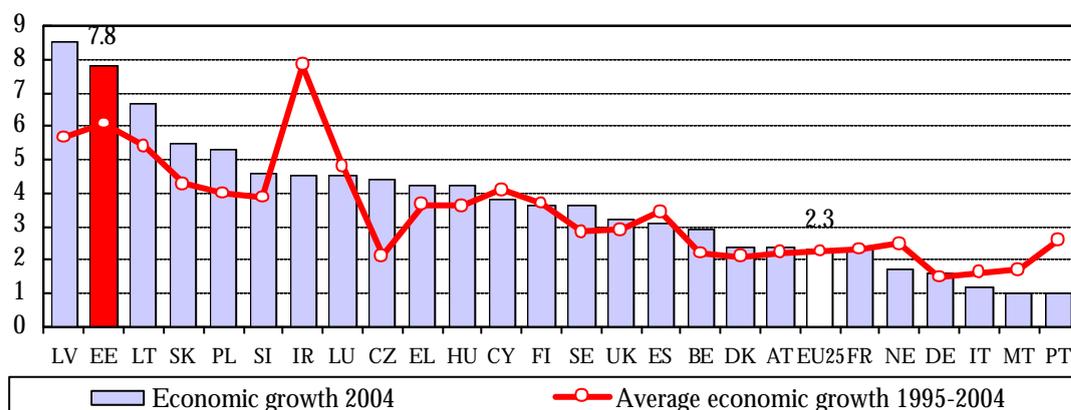
#### A. GDP *per capita* considering purchasing power parity in 2004

(EU25=100)



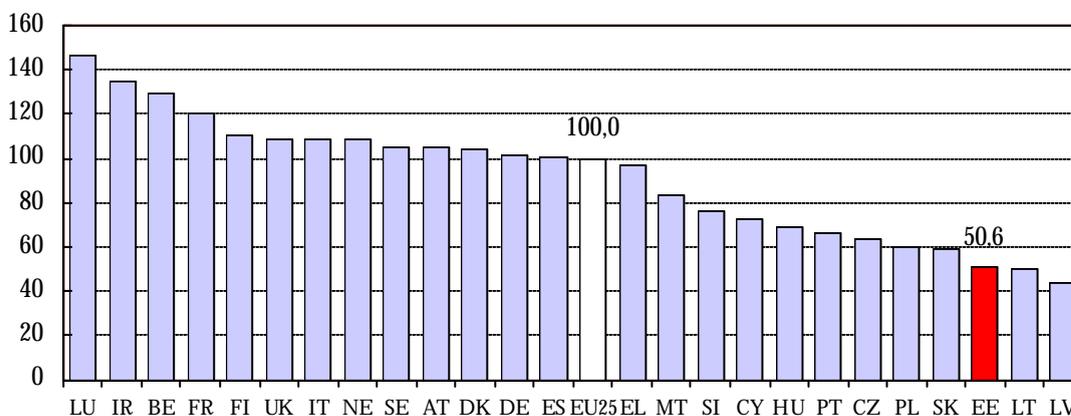
#### B. Economic growth in 2004

(percentage)



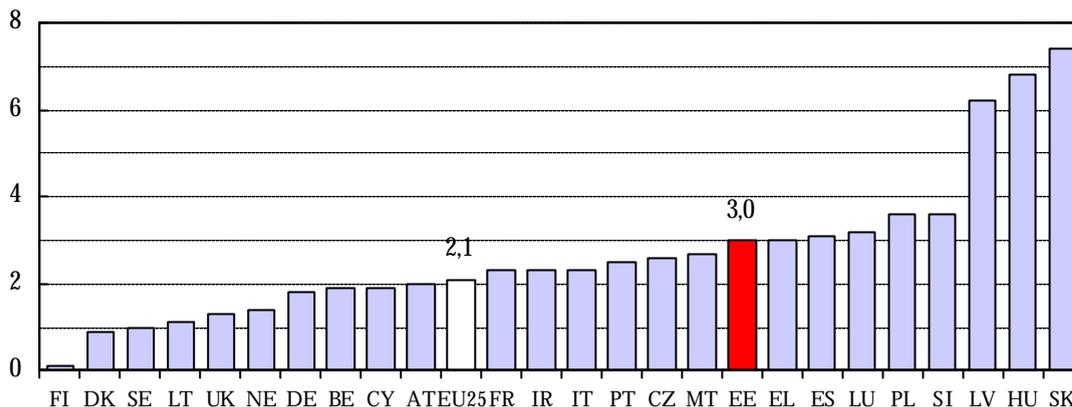
#### C. Labour productivity – GDP per employee considering purchasing power parity in 2004

(EU25=100)



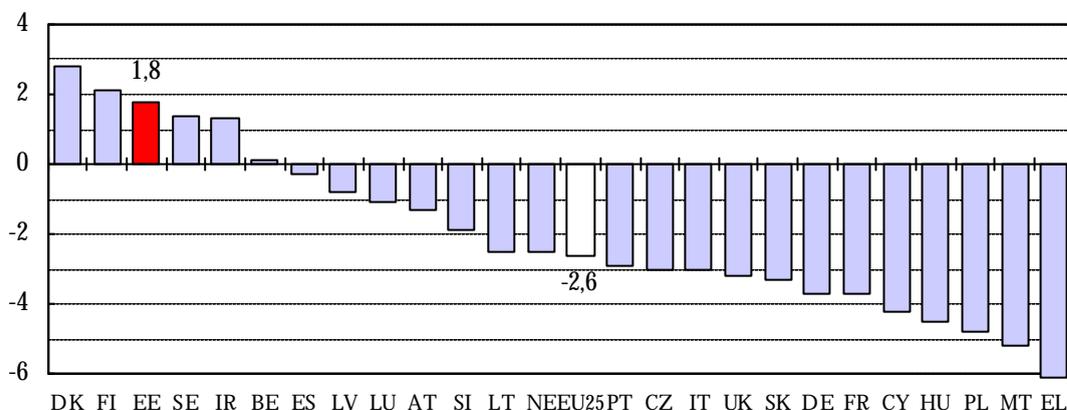
**D. Harmonized consumer price index in 2004**

(percentage)



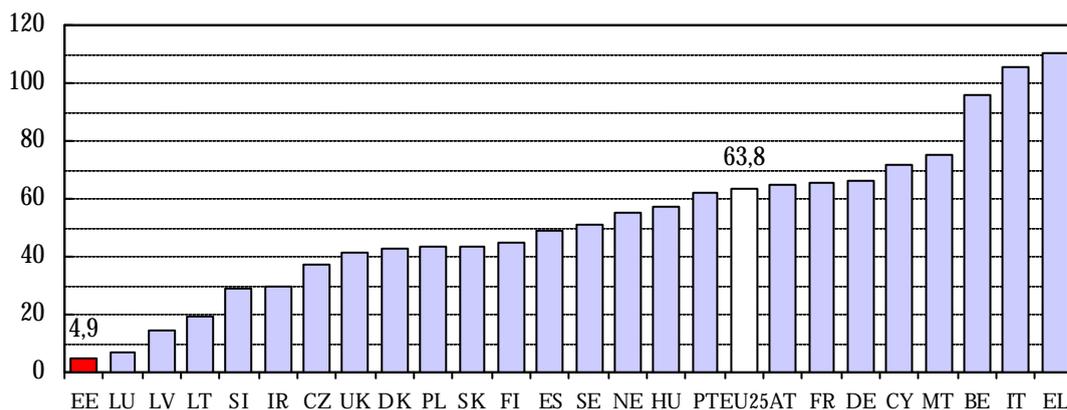
**E. Governmental sector budgetary scale in 2004**

(% of GDP)



**F. Governmental sector debt in 2004**

(% of GDP)



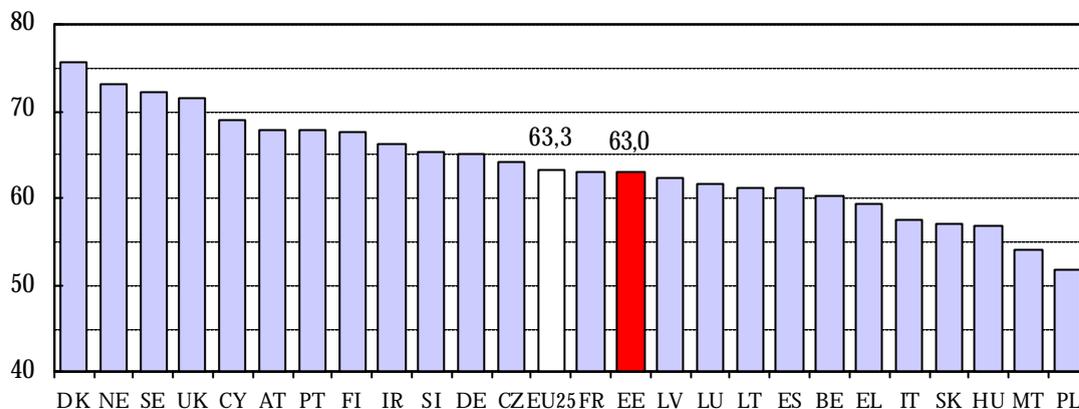
Sources: Eurostat, Estonian Statistics Office, Ministry of Finance.

**Diagram 11**

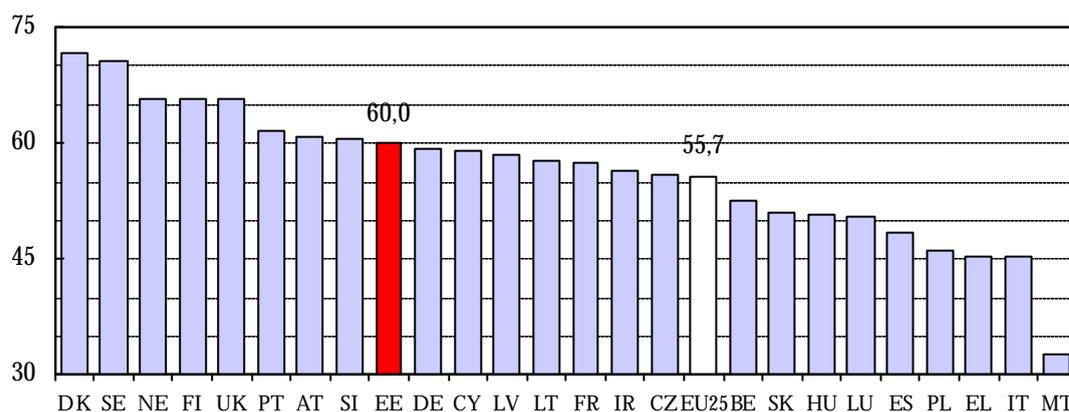
**Employment**

(percentage)

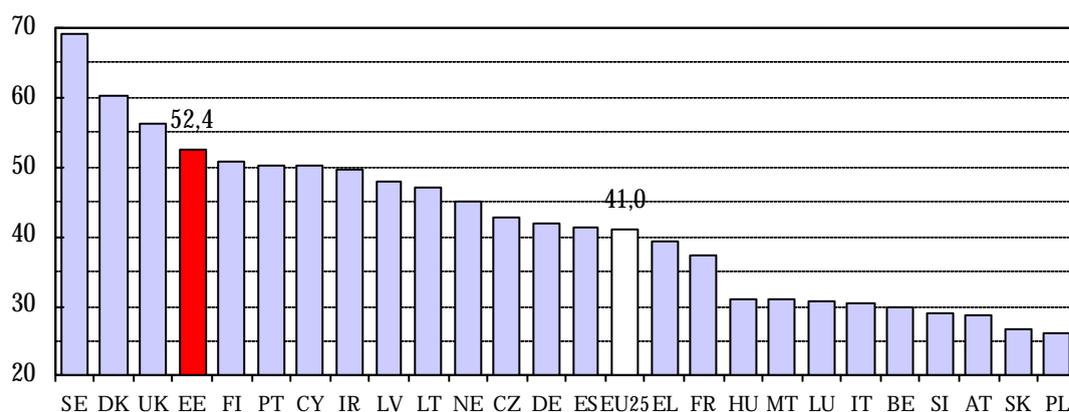
**A. Employment rate (15–64-year-olds) in 2004**



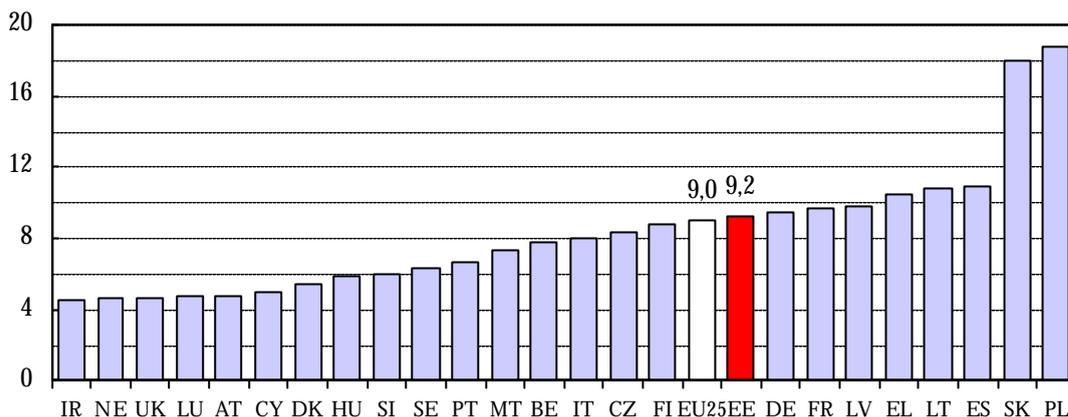
**B. Employment rate of women (15–64-year-olds) in 2004**



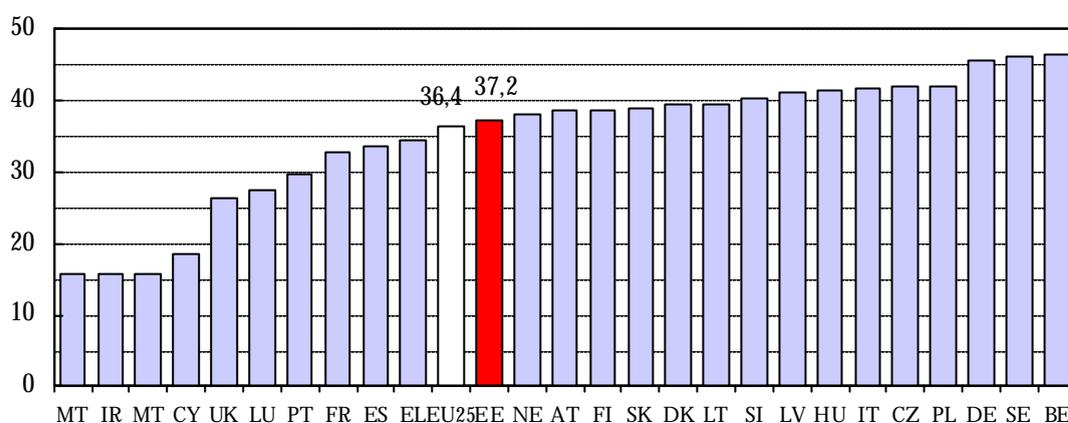
**C. Employment rate of older workers (55–64-year-olds) in 2004**



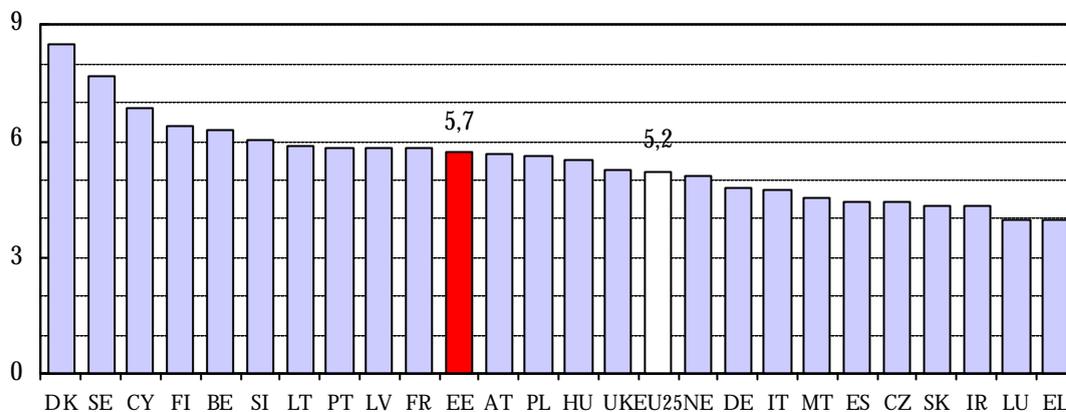
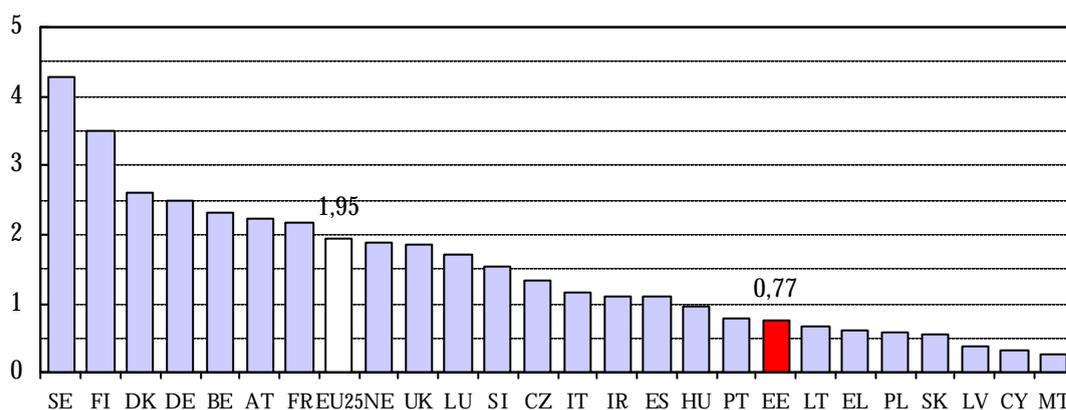
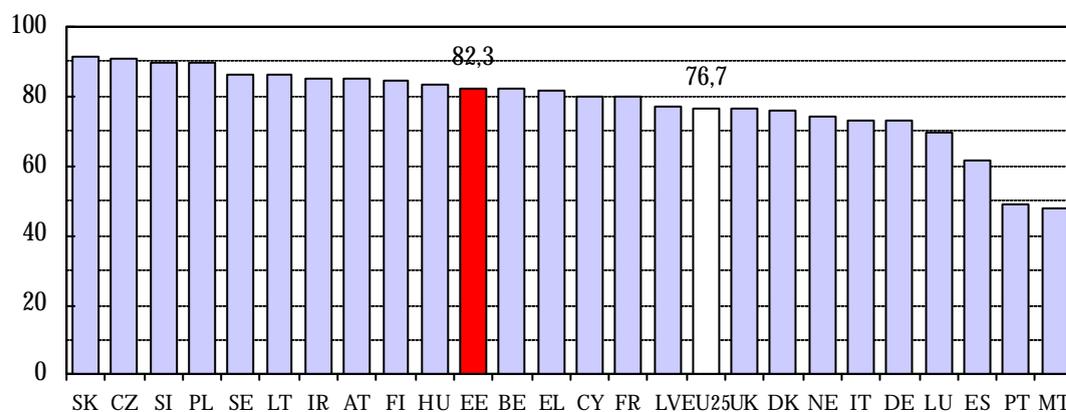
**D. Unemployment rate (15-74-year-olds) in 2004**



**E. Tax burden of low-income workers in 2004**



Sources: Eurostat, Estonian Statistics Office, Ministry of Finance.

**Diagram 12****Innovation and research and development activities***(% of GDP)***A. Educational expenses in 2002****B. R&D expenditures in 2003****C. Education level of young people (Percentage of 20-24-year-olds with at least a secondary education) in 2004***(percentage)*

Sources: Estonian Statistics Office, Eurostat.

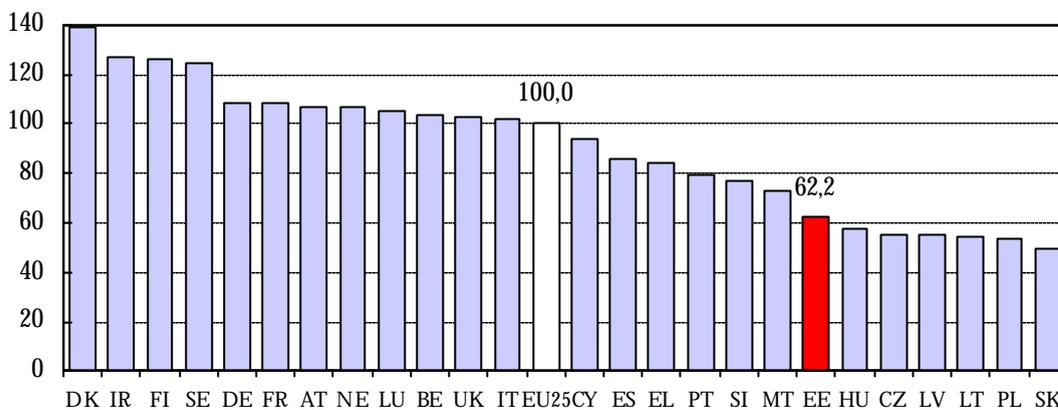
**Diagram 13**

**Economic reform**

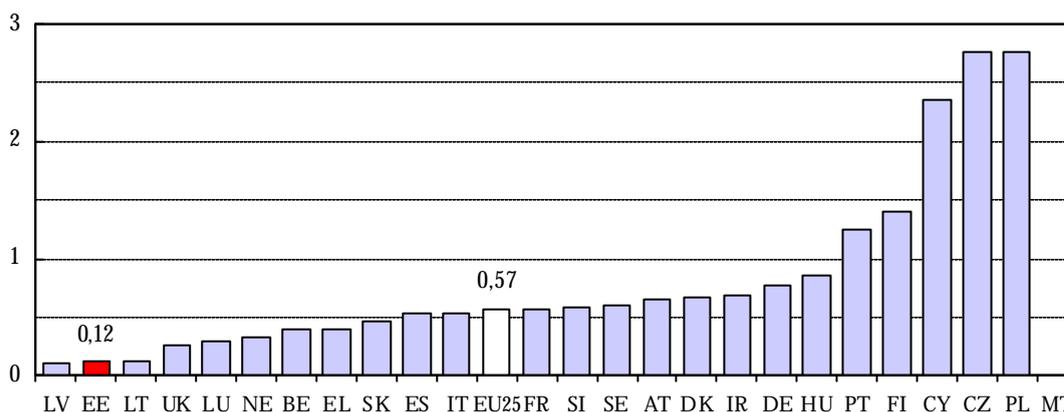
(% of GDP)

**A. Price level comparison with the EU25 average in 2003**

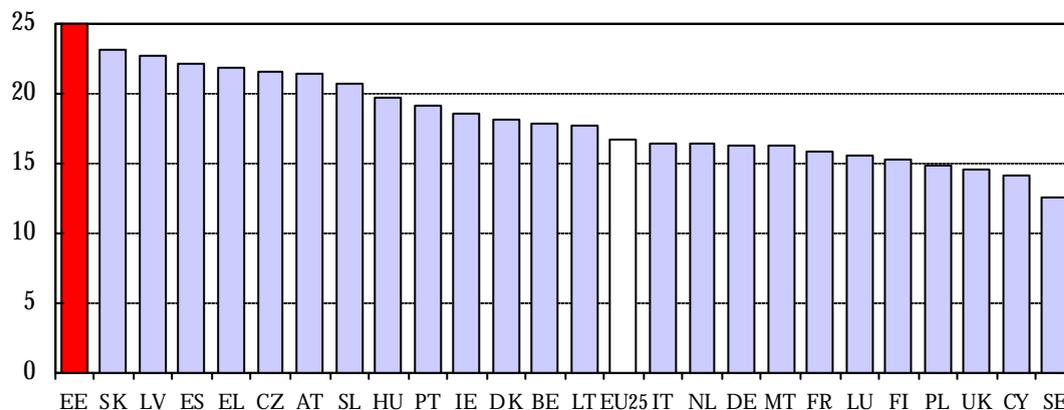
(EL15=100)



**B. State aid in 2003**



**G. Private sector investments in 2003**



## **Appendix 3. The composition and assignments of the working group created to elaborate the Action Plan**

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### DIRECTIVE

Tallinn

13 July, 2005 No 92

### **Formation of the working group**

On the basis of subsection 79 of the “Government of the Republic Act”, and subclause 10, subclause 15 of the “Statutes of the State Chancellery” approved by the Government of the Republic regulation No 278 of 12 November 1996:

1. I establish a working group to work out the Estonian Action Plan for Growth and Jobs within the framework of the Lisbon strategy with following membership:

Head of the working group:	Keit Kasemets	Director of the European Union Secretariat of the State Chancellery
Members of the working group:	Eve Vahter Kairit Peterson Kalev Kukk Ülo Kaasik  Anne Kivimäe  Heli Aru  Indrek Reimand  Kalle Toom  Karmen Vilms  Allan Gromov  Mari Lahtmets  Signe Ratso  Ahti Kuningas	Counsellor of the European Union Secretariat Counsellor of the State Chancellery Adviser to the Prime Minister Head of the Economic Analysis Department, Bank of Estonia  Head of the Youth Affairs Department, Ministry of Education and Research  Counsellor for Education and Labour Market, Ministry of Education and Research  Head of the Research and Higher Education Department, Ministry of Education and Research  Head of the Vocational Education Office of the Vocational and Adult Education Department, Ministry of Education and Research  Head of the Legislation Drafting Bureau of the Legal Policy Department, Ministry of Justice  Deputy Secretary General for International Cooperation, Ministry of the Environment  Head of the Strategy and Investment Department, Ministry of the Environment  Deputy Secretary General for the European Union and International Cooperation, Ministry of Economic Affairs and Communications  Head of the Economic Development Department, Acting Deputy Secretary General for Economic Development, Ministry of Economic Affairs and Communications

Janno Järve	Deputy Secretary General on Labour Policy, Ministry of Social Affairs <sup>78</sup>
Katrin Höövelson	Head of Labour Market Department, Ministry of Social Affairs
Kert Valdaru	Deputy head of the Aliens Department, Ministry of Internal Affairs
Andrus Säälük	Head of the Economic Analysis Department, Ministry of Finance
Ivar Sikk	Head of the State Budget Department, Ministry of Finance
Renaldo Mändmets	Deputy Secretary General for Foreign Relations, Ministry of Finance
Veiko Tali	Deputy Secretary General for Financial Policy, Ministry of Finance
Maris Lauk	Attaché of the European Union Department, Ministry of Foreign Affairs
Harri Taliga	Chairman, Confederation of Estonian Trade Unions
Siim Raie	Director General, Estonian Chamber of Commerce and Industry
Raivo Vilu	Member of the Estonian Council of Environmental NGOs
Jaanus Tamkivi	Chairman of the Board, Association of Estonian Cities
Kurmet Mürsepp	Chairman, Association of Municipalities of Estonia
Rein Voog	Member of the Supervisory Board, Estonian Federation of Non-Profit Organizations and Foundations
Richard Villems	President, Estonian Academy of Sciences
Tarmo Kriis	Chairman, Estonian Employers' Confederation
Väino Verlin	Member of Executive Board, Estonian Employees' Unions' Confederation

2. The working group's assignment is to compile the Estonian Action Plan for Growth and Jobs 2005-2007 for the implementation of the Lisbon strategy. The working group shall submit the Action Plan to the Government for approval on 22 September.

3. The working group has the right to form sub-groups and to involve representatives of state and local government institutions and independent experts.

4. The State Chancellery provides the working group with administrative services.

Heiki Loot  
Secretary of State

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<sup>78</sup> Deputy Secretary General as of August, 2005