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**THROUGH:** Jeffrey May  
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**FROM:** Shauna Lee-Alaia  
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**DATE:** February 28, 2003

**SUBJECT:** Decision Memorandum Regarding Estonia's Status as a  
Non-Market Economy Country for Purposes of the  
Antidumping and Countervailing Duty Law under a  
Changed Circumstances Review of the Solid Urea Order  
Against Estonia

**SUMMARY**

The Government of Estonia ("GOE") has implemented economic and institutional reforms aimed at establishing a market economy since regaining its independence in 1991. As a result, we believe that Estonia has successfully made the transition to a market-economy country.

The reforms initiated by the GOE specifically relating to the factors examined by the Department under section 771(18)(B) are comprehensive. The Estonian *kroon*, established in 1992, is freely convertible for both current and capital account purposes. There are no restrictions on repatriation of earnings. The central bank, the Bank of Estonia (“BOE”), sets monetary policy and regulates private-sector banks, independent of the government. Wages are freely negotiated between employees and management. The right to unionize and bargain collectively is guaranteed by law. Foreign and domestic investors are treated equally. In fact, Estonia enjoys one of the highest foreign direct investment (“FDI”) per capita rates in the region. Privatization of most medium-sized and large industrial enterprises is complete, with 80 percent of gross domestic product (“GDP”) in the hands of the private sector. Private property rights are respected in Estonia. Both foreigners and Estonians are able to own agricultural and non-agricultural land. Entrepreneurship is encouraged by the GOE and adequately protected *de jure* and *de facto*. The financial sector, predominately foreign owned and completely privately owned, acts as a financial intermediary. Consumer prices were liberalized in 1992. As of mid- 2002, Estonia had closed 26 of 31 chapters of its *acquis communautaire* and is expected to join the European Union in 2004. Estonia has been a member of the World Trade Organization (“WTO”) since November 1999.

Overall, we believe that Estonia has made far-reaching changes in the structure of its economy resulting in a successful transition to a market economy. Under section 771(18)(B) of the Act, we recommend that the U.S. Department of Commerce find that Estonia has a functioning market-economy. We have determined that the effective date for the consideration of Estonia as a market economy is January 1, 2003. Estonia producers and exporters will be subject, therefore, to the antidumping rules applicable to market economies with respect to the analysis of transactions occurring after January 1, 2003. In addition, the U.S. countervailing duty law will apply now to Estonia where the proceeding at issue involves an adequate period of investigation after this effective date.

## **BACKGROUND**

The Department has treated Estonia as an NME country in antidumping duty investigations and administrative reviews. See, *e.g.*, Urea From the Union of Soviet Socialist Republics; Final Determination of Sales at Less Than Fair Value, 52 FR 19557 (May 26, 1987); and, Solid Urea from the Union of Soviet Socialist Republics - Transfer of the Antidumping Duty Order on Solid Urea From the Union of Soviet Socialist Republics to the Commonwealth of Independent States and the Baltic States and Opportunity to Comment, 57 FR 28828 (June 29, 1992). A designation as a NME remains in effect until it is revoked by the Department. See section 771(18)(C)(i) of the Act.

The Department received a letter from the Republic of Estonia Ministry of Foreign Affairs dated July 10, 2002, requesting a review of Estonia's status as a non-market economy (“NME”) country. In the letter, the Government of Estonia submitted documentation supporting its request for market economy status. The Department subsequently received a letter from the Ambassador of Estonia to the United States dated September 20, 2002, requesting a review of Estonia's non-market

economy status under a changed circumstances review of the antidumping duty order on solid urea from Estonia. In response to this latter request, the Department initiated a changed circumstances review in order to examine whether Estonia is still a non-market economy country for purposes of the antidumping and countervailing duty laws, pursuant to sections 751(b) and 771(18)(C)(ii) of the Act.

The Department published a Notice in the Federal Register requesting comments from the public concerning this matter on October 16, 2002. Comments were due no later than December 2, 2002 and rebuttal comments were due January 02, 2003. The GOE has submitted comments supporting its request to revoke Estonia's NME status. No comments were received by the Department opposing the GOE's request.

#### *Parties Who Support a Determination of Estonia as a Market Economy*

The Government of Estonia submitted comments summarized below in support of a determination of Estonia as a market economy.

- The Estonian monetary system since 1992 has been based on a currency board arrangement, with the Estonian *kroon* currently pegged to the euro.
- There are no restrictions on capital transactions.
- Wages are determined by market forces, though there exists a government-imposed minimum wage and cooperative agreements.
- The Estonian government maintains a highly favorable attitude towards foreign investment.
- Though the government does not screen investments, it does establish requirements for certain sectors (i.e. utilities, transport, and waterways) to regulate and establish clear ownership responsibilities.
- The amount of foreign capital that can be invested in Estonian business is not limited. Full foreign ownership is authorized.
- Privatization of state-owned industrial enterprises is virtually complete.
- Prices are determined freely by market forces, except in heating and electricity.
- The European Union has regarded Estonia as a market economy and Estonian government is in ongoing accession negotiations with the EU.
- According to the 2002 Index of Economic Freedom, Estonia was ranked as the fourth freest economy in the world.

#### **ANALYTICAL APPROACH**

In reviewing a country's NME status under section 771(18)(A) of the Act, section 771(18)(B) of the Act requires that the Department take into account the following six factors:

1. The extent to which the currency of the foreign country is convertible into the currency of other countries.
2. The extent to which wage rates in the foreign country are determined by free bargaining between labor and management.
3. The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country.
4. The extent of government ownership or control of the means of production.
5. The extent of government control over the allocation of resources and over the price and output decisions of enterprises.
6. Such other factors as the administering authority considers appropriate.

In evaluating the six factors listed above, the Department has recognized that it is not sufficient that a country's economy is no longer controlled by the state to treat the country as a market economy. Rather, the Department considers whether the facts, as applied to the statutory factors, demonstrate that the economy is generally operating under market principles. To this end, Congress has provided the above listed factors which the Department must evaluate to determine whether, in the judgment of the Department, market forces in the country are sufficiently developed to permit the use of prices and costs in that country for purposes of the Department's dumping analysis.

Prices and costs are central to the Department's dumping analysis and calculation of normal value. Therefore, the prices and costs that the Department uses must be meaningful measures of value. NME prices are not, as a general rule, meaningful measures of value because they do not sufficiently reflect demand conditions or the relative scarcity of resources used in production. The problem with NMEs is not one of distorted prices, *per se*, since few, if any, market economy prices are perfect measures of value, free of all distortions (*e.g.*, taxes, subsidies, or other government regulatory measures). The problem, instead, is the price *generation* process in NMEs (*i.e.*, the absence of the demand and supply elements that individually and collectively make a market-based price system work).

The Department's evaluation of the statutory criteria does not require that countries be judged against a theoretical model or a perfectly competitive *laissez-faire* economy. Instead, the Department's determination is based on comparing the economic characteristics of the country in question to how other market economies operate, recognizing that market economies around the world have many different forms and features. Although it is not necessary that the country fully meet every statutory factor relative to other market economies, the Department must determine that the factors, taken together, indicate that reforms have reached a threshold level such that the country can be considered to have a functioning market economy.

The Department used numerous reports and analyses produced by third parties such as the World Bank, the International Monetary Fund, the European Bank for Reconstruction and Development, and the Organization for Economic Cooperation and Development in evaluating and

applying the statutory criteria.

## **ANALYSIS OF SECTION 771 (18) (B) Factors**

### ***Factor One. The extent to which the currency of the foreign country is convertible into the currency of other countries.***

A country's integration into world markets is highly dependent upon the convertibility of its currency. The greater the extent of currency convertibility, for both trade and investment purposes, the greater are the supply and demand forces linking domestic market prices in the country to world market prices. The greater this linkage, the more market-based domestic prices tend to be.

#### **A. Legal Framework**

Under the *Law on the Central Bank of the Republic of Estonia*, passed in 1993 and amended most recently in 2002, the central bank, *i.e.*, the Bank of Estonia ("BOE"), is independent from all government agencies and reports only to the Parliament.<sup>1</sup> All licensed banks are permitted to engage in the foreign exchange market.<sup>2</sup> The conditions and procedures for exchanging *kroon* are determined by the BOE.<sup>3</sup>

The *Currency Law of the Republic of Estonia* established the *kroon* as the official monetary unit in 1992 and granted the BOE the sole right to issue and to remove currency from circulation.<sup>4</sup> The *Law on the Security of the Estonian Kroon*, which became effective in June 1992, pegged the *kroon* to the German mark, with fluctuations limited to 3 percent. The *kroon* is now pegged to the euro at approximately 15.6 per 1 euro.<sup>5</sup>

The Estonian monetary system is based on a currency board arrangement ("CBA"), as provided for in the *Law on the Security of the Estonian Kroon*.<sup>6</sup> Only the parliament may change the

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<sup>1</sup> Law No. RT I 1993 28,498 *Law on the Central Bank of the Republic of Estonia* (1993 as amended in 2002).

<sup>2</sup> *Law on Banks*, Article 2(11) (1991).

<sup>3</sup> Law No. RT 1992, 21, 299 *Currency Law of the Republic of Estonia*, Article 5 (1992). See also Law No. RT I 1993 28, 498 *Law on the Central Bank of the Republic of Estonia*, Article 15 (1993, as amended in 2002).

<sup>4</sup> Law No. RT 1992, 21, 299 *Currency Law of the Republic of Estonia* (1992).

<sup>5</sup> Eesti Pank Decree No 39 *Fixing the Exchange Rate of Estonian Kroon against Euro* (1998).

<sup>6</sup> Law No. RT 1992 21 300 *Law on the Security of the Estonian Kroon* (1992). The Currency Board Arrangement includes a legislated obligation to maintain a fixed exchange rate and the requirement that domestic currency is only issued against

exchange rate and the BOE is prohibited from devaluing the *kroon*. After accession to the European Union, Estonia will join the Economic and Monetary Union, thereby adopting the *euro* as its currency. However, the CBA will be maintained during both the pre- and immediate post-accession periods.

## **B. Developments in the Economy**

The *kroon* is fully convertible for current account purposes, *i.e.*, transactions involving trade, income and profit remittances. Estonia has been a signatory to IMF Article VIII since August 1994.<sup>7</sup> There are no restrictions on repatriating funds. Entities conducting business in Estonia have reported no problems with closing down a business and repatriating all assets. Foreign exchange (“FOREX”) is readily available.<sup>8</sup>

The BOE was established in 1990 and became the central bank after its merger with the Estonian Branch of Gosbank in 1992. BOE withdrew from commercial banking and redirected its focus on monetary policy and regulating private sector banks.<sup>9</sup> The BOE is limited in its ability to increase the money supply. By law, hard currency reserves must increase in proportion to the money in circulation, therefore monetary expansion is only possible if the country experiences a net inflow of foreign currency.<sup>10</sup>

The currency board is operated by the BOE, which can only issue new currency in proportion to the growth of its foreign assets and reserves.<sup>11</sup>

### **Assessment of Factor**

The BOE sets monetary policy and regulates private financial institutions in an independent and transparent manner. The GOE has established a stable currency regime. The Estonian *kroon* is fully convertible for both current and capital account transactions. There are no FOREX surrender

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foreign exchange. The board must also stand ready to exchange domestic currency for reserve currency at a specified and fixed exchange rate backed with foreign reserves or gold. The currency board has extremely limited power to pursue an independent monetary policy.

<sup>7</sup> *Estonia and the International Monetary Fund at a Glance* (International Monetary Fund) online at <http://www.imf.org/external/country/est/rr/glance.htm>.

<sup>8</sup> *Estonia Country Commercial Guide FY2001* (Washington DC: US Commercial Service, 2001).

<sup>9</sup> *The Economist Intelligence Unit; Country Profiles, Estonia*, June 1, 2001.

<sup>10</sup> See *id.*

<sup>11</sup> See *id.*

requirements.

***Factor Two. The extent to which wage rates in the foreign country are determined by free bargaining between labor and management.***

This factor focuses on the manner in which wages are set because they are an important component of a producers' costs and prices and, in turn, are an important indicator of a country's overall approach to setting prices and costs in the economy. The reference to "free bargaining between labor and management" reflects concerns about the extent to which wages are market-based, *i.e.*, about the existence of a market for labor in which workers and employers are free to bargain over the terms and conditions of employment.

**A. Legal Framework**

Estonia has a legal framework which establishes the rights, obligations and guarantees of workers and employers that form both the basis for free bargaining over wages and other terms and conditions of employment. Labor rights are protected by the Constitution, under which a citizen has the right to freely choose a profession and place of work, freedom from compulsory work (excepting conscription), and the freedom to strike and belong to unions and employee federations.<sup>12</sup>

The main principles of Estonian labor law are set out in the *Employment Contracts Act*, which entered into force in July 1992.<sup>13</sup> This law regulates the general procedures for drawing up, altering, and terminating employment contracts. Workers are free to leave their employment at will. Similarly, employers are free to terminate employment contracts.

Under the *Wages Act*, passed in 1994, wages are set through individual negotiations via an employment contract or through collective bargaining. Employers are free to set wages at any level above the statutory minimum wage.<sup>14</sup>

The *Trade Union Act*, passed in June 2000 and amended in September 2002, defines unions as legally independent associations with the right to fully represent the interests of their members. The Act also provides for the right to join and found unions.<sup>15</sup> Collective agreements, determining salary condition, working hours and other important work terms, are binding on all members to the agreement.

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<sup>12</sup> *The Constitution of the Republic of Estonia*, Section 29 (1992).

<sup>13</sup> Law No. RT 1992 15/16, 241 *Employment Contract Act* (1992).

<sup>14</sup> Law No. RT I 1994, 11, 154 *Wages Act* (1994).

<sup>15</sup> Law No. RT I 2000, 57, 372 *Trade Unions Act* (2000 as amended in 2002).

In general, the term of a collective agreement is one year, unless the parties have agreed otherwise.

The *Collective Labour Dispute Resolution Act*, passed in 1993, provides for the procedures of the resolution of collective labor disputes and the calling of strikes and lock-outs.<sup>16</sup> The *Individual Labour Dispute Resolution Act*, passed in 1995, provides the procedures for the resolution of disputes between individual employees and employers via labor dispute committees or the courts.<sup>17</sup>

## **B. Developments in the Economy**

Employment in Estonia is based on legally binding contractual relations, an essential component to freely negotiated wage formation. Wages tend to vary geographically and across sectors. The average salary in Estonia was \$337 a month for the first quarter of 2002 which, although low, is higher than in either Lithuania (\$272) or Latvia (\$269).<sup>18</sup> Moreover, wages in Estonia are trending upwards.<sup>19</sup> The official unemployment rate was 5.3 percent in 2000, however this is undoubtedly an underestimate since most unemployed do not register with the government. Labor surveys have put the figure closer to 13-14 percent for the past couple of years.<sup>20</sup> High unemployment rates are regional and are most common in the north-east where industrial jobs continue to decline as the economy creates more jobs in the information technology sector.<sup>21</sup> There are no restrictions on labor mobility, although in practice mobility is low because there is a shortage of housing in urban areas.<sup>22</sup>

Labor Unions are permitted and currently about a third of the work force is a member of one of the three main unions: the Central Organization of Estonian Trade Unions, Organization of Employee Unions, Central Union for Food Processing and Rural Workers. Though permitted by law, strikes are extremely rare. This is partly due to legal constraints, including prerequisites of a lengthy conciliation process and at least two weeks notice before a strike.<sup>23</sup> Collective bargaining is therefore still

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<sup>16</sup> Law No. RT I 1993, 26,442 *Collective Labour Dispute Resolution Act* (1993).

<sup>17</sup> Law No. RT I 1996, 3, 57 *Individual Labour Dispute Resolution Act* (1995).

<sup>18</sup> Bozhko, Oleg, *Have Living Conditions Improved? At Least 30 years to reach the standard of living* (The Baltic Course) online at [http://www.baltkurs.com/english/archive/summer\\_2002/02economics.htm](http://www.baltkurs.com/english/archive/summer_2002/02economics.htm).

<sup>19</sup> Statistical Office of Estonia, online at <http://www.stat.ee/>.

<sup>20</sup> *Estonia Country Commercial Guide FY2001* (Washington DC: US Commercial Service, 2001).

<sup>21</sup> *The Economist Intelligence Unit; Country Profiles, Estonia*, June 1, 2001.

<sup>22</sup> See id.

<sup>23</sup> Eamets, Raul, *Free collective bargaining - the right model for the accession countries?*, University of Tartu, Estonia (2002) p 6.



developing as a negotiating tool.<sup>24</sup> The largest trade union, the Central Organization of Estonian Trade Unions, participated in developing Estonia's post-Soviet labor code.<sup>25</sup> Additionally, Estonia adheres to the International Labour Organization conventions protecting worker rights.<sup>26</sup>

### **Assessment of Factor**

Estonia has made considerable progress under this factor. Employees are able to freely negotiate their wages with management, with or without union involvement. Wages, while still low, are increasing. Estonia enjoys a labor market where wages are set by market forces.

***Factor Three. The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country.***

Opening an economy to FDI tends to expose domestic industry to competition from market-based suppliers and the management, production and sales practices that they bring. It also tends to limit the scope and extent of government control over the market, since foreign investors, as a general rule, demand a certain degree of autonomous control over their investments.

#### **A. Legal Framework**

Under the prior *Foreign Investments Act*, enacted in 1991 and subsequently repealed in 2000, foreign investors were granted "equal rights and obligations" with domestic investors, unless proscribed in other national legislation, such as land rights.<sup>27</sup> The act guaranteed the right to repatriate profits, dividends and invested capital, and protected against expropriation. However, the act also provided that FDI could be restricted or licenses required for foreign investment in certain areas of activity as specified by the Estonian government.

Following the repeal of the law, all business activity is now governed by the *Commercial Code*, which took effect on September 1, 1995.<sup>28</sup> The *Commercial Code* provides the definitions for entrepreneur and permissible commercial undertakings, such as sole proprietorships, general partnerships, limited partnerships, private limited liability companies, public limited companies and

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<sup>24</sup> See id.

<sup>25</sup> *Strategy for Estonia* (London: European Bank for Reconstruction and Development, 2002) p 13.

<sup>26</sup> *Estonia Country Commercial Guide FY2001* (Washington DC: US Commercial Service, 2001).

<sup>27</sup> *OECD Reviews of Foreign Direct Investment: Estonia* (Paris: Organisation for Economic Cooperation and Development, 2001) p 40.

<sup>28</sup> Law No. RT I 1995, 26/28, 355 *Commercial Code* (1995).

commercial cooperatives. Foreign investors may establish all forms of business entities. Wholly-owned foreign invested enterprises are allowed without restrictions.

Licences, granted on a non-discriminatory basis, are required for business activities in certain sectors. These sectors are often subject to government regulation in market economies.<sup>29</sup> In July 2002, the GOE passed Regulation No 208, *Statutes of the State Register of Undertakings Operating In Areas of Activity Subject to Special Requirements*, which stipulates the natural monopoly sectors for which registration is required, including travel, electricity, and alcohol import/export.<sup>30</sup>

The *Act on the Arbitration Court of the Estonian Chamber of Commerce and Industry*, passed on August 18, 1991, governs arbitration proceedings.<sup>31</sup> Procedural rules for such proceedings are established by the *Rules of the Arbitration Court of the Estonian Chamber of Commerce and Industry*. Decisions are final and not subject to appellate review.

## **B. Developments in the Economy**

Estonia's legal framework is largely in conformity with EU legislation.<sup>32</sup> Since the Foreign Investments Act was revoked in 2000, investment is permitted in all sectors. The licensing and registration requirements are similar to those found in many market economies. There are no special tax incentives afforded to foreign investors and foreign and domestic investors now compete on a level playing field.

The GOE has been successful in attracting FDI. FDI per capita in Estonia for 2001 was \$390 compared with Estonia's Baltic neighbors Lithuania and Latvia at \$127 and \$85 respectively. Estonia's FDI inflows are closer to those found in the traditionally more advanced economies of central and

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<sup>29</sup> These sectors include transportation, mining, metal, industries relating to national securities such as arms, health, environment, money printing, education, banking, insurance and telecommunications. *OECD Reviews of Foreign Direct Investment: Estonia* (Paris: Organisation for Economic Cooperation and Development, 2001) p 43.

<sup>30</sup> Regulation No. 208 *Statutes of the State Register of Undertakings Operating in Areas of Activity Subject to Special Requirements* (2002) cited in *Legal Update - The Baltic States, Commercial Law*, No. 19, July - August 2002 (Sorainen Law Offices) online at [http://www.sorainen.com:90/legal/legal/Baltic\\_Legal\\_Update\\_July\\_02-August\\_02\\_english.pdf](http://www.sorainen.com:90/legal/legal/Baltic_Legal_Update_July_02-August_02_english.pdf).

<sup>31</sup> Law No. 1991 25,308 *Act on the Arbitration Court of the Estonian Chamber of Commerce and Industry* (1991).

<sup>32</sup> Liberalization on the field of capital movement is almost complete with the main remaining restriction relating to FDI in security service, air transport and the ownership of sea going vessels. Issues of FDI in the transportation sector will be addressed after accession. See *2002 Regular Report on Estonia's Progress Towards Accessions* (Brussels: Commission of the European Community, 2002) p 55.

eastern Europe, where FDI, for example, stands at \$478 for Czech Republic and \$245 for Hungary.<sup>33</sup>

Where other transition economies have seen a decrease in FDI inflows as the privatization process slowed down, Estonia's FDI has continued to increase year to year.<sup>34</sup> Investors have been drawn to Estonia because of its access to neighboring markets, with Sweden and Finland accounting for over 70 percent of total FDI in 2000.<sup>35</sup>

Estonia's financial sector attracted the largest share of FDI after it restructured and consolidated in the middle to late 1990s. Transport, communications, manufacturing, and wholesale and retail trade received the bulk of the remaining FDI.<sup>36</sup>

### **Assessment of factor**

Estonia has made considerable progress under this factor. FDI has consistently been one of the highest in the region. All forms of business enterprises are allowed in Estonia. Foreign and domestic investors are afforded the same opportunities and legal protections.

#### ***Factor Four. The extent of government ownership or control of the means of production.***

The right to own private property is fundamental to the operation of a market economy, and the scope and extent of private sector involvement in the economy often is an indicator of the extent to which the economy is market-driven. In assessing this factor there are two areas to consider, 1) Estonia's privatization program, and 2) land reforms.

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<sup>33</sup> *International Financial Statistics Yearbook 2002* (Washington: International Monetary Fund, 2002).

<sup>34</sup> The exception was 1998, where FDI was extremely high because of two large Swedish banks investing in the financial sector. *Estonia Investment Profile 2001* (London: European Bank for Reconstruction and Development, 2001) p 9.

<sup>35</sup> *OECD Reviews of Foreign Direct Investment: Estonia* (Paris: Organisation for Economic Cooperation and Development, 2001) p 14.

<sup>36</sup> *Estonia Investment Profile 2001* (London: European Bank for Reconstruction and Development, 2001) p 9.

## 1) Privatization

### A) Legal Framework

Under the 1990 *Law on Ownership* and the *Law on the Privatization of State Owned Service, Retail and Catering Enterprises*, the GOE formulated the first plan for privatization which began with the sale of a limited number of state-owned enterprises (“SOEs”) in these sectors. The latter law was subsequently amended by the 1991 *Law on the Basis of Property reform*, which provided the legal basis for restitution and the use of vouchers as a tool for privatization, and the 1992 *Law on Privatization of State and Municipal Enterprises*, under which the Privatization Agency was established and international tenders were offered.

Both laws were replaced by the 1993 *Law on Privatization* and 1993 *Law on the Basis of Ownership Reform*. Together, these two laws provided the basis for privatizations, allowing for the sale of shares by way of tenders, the sale of property or structural units at public or restricted auctions, and public offerings of shares.<sup>37</sup>

### B) Economic Developments

Estonia’s privatization process, which began in 1990, is essentially complete. The GOE chose to follow the German model for privatizing state assets by granting great authority and independence to the Privatization Agency.<sup>38</sup> Eighty percent of GDP is now in the hands of the private sector.<sup>39</sup>

Estonia chose to use a tender method for large scale privatization, over a voucher scheme and or management/employee buy-outs, reducing fragmented ownership and encouraging strong investors. Public auction was used when the sale was fairly simple and did not require complex investment specifications. Public Offerings, available only to a minority share, were used in order to generate interest in a large company and protect the stake of the majority shareholder. The privatization of non-infrastructure enterprises was completed in 1995.<sup>40</sup>

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<sup>37</sup> Purjo, Alaki, *The Political Economy of Privatization in Estonia*, Centre for Economic Reform and Transformation (Edinburgh 1996) p 6-22.

<sup>38</sup> For a discussion of the decision to adopt the German or Treuhandanstalt method, see Wolfe, James, *Privatization in the Former Soviet Union; The Use of International Tenders* (Institute of Baltic Studies), online at <http://www.ibs.ee/ibs/economics/privatization.html>.

<sup>39</sup> Transition Report 2002, Economic Transition in Central and Eastern Europe and the CIS (London: European Bank for Reconstruction and Development, 2002) p 20.

<sup>40</sup> *OECD Reviews of Foreign Direct Investment: Estonia* (Paris: Organisation for Economic Cooperation and Development, 2001) p 58.

The Estonian Privatization Agency was phased out at the end of 2001.<sup>41</sup> Responsibility for privatizing the few remaining entities slated for privatization has been transferred to the Finance Ministry.<sup>42</sup> A special team was created to handle the privatization of the few remaining politically sensitive enterprises. This program is mostly complete, including the privatization of a broadcast company, a hotel complex, the largest rail freight operator, the passenger rail service, and Tallinn's water utility.<sup>43</sup>

Energy sector reforms in Estonia are well underway. The bulk of electricity production and distribution is provided by a state-owned firm that has been largely restructured. In particular, electricity prices in Estonia were liberalized to all customers in 2002, who can now choose their electricity supplier.<sup>44</sup> Other sources of energy, such as oil shale and natural gas, are supplied by majority foreign-owned companies, including U.S. and Russian firms.<sup>45</sup>

## **2) Land**

### **A) Legal Framework**

Under the Constitution, the property of every person is inviolable and protected by law, including the right to freely possess, use and dispose of personal and real property. Expropriation is only permitted when in the public interest and for fair and immediate compensation.<sup>46</sup> The *Law of Property Act*, which entered into force in January 1994, defines and governs the formation and termination of property rights. Under the Act, property rights are divided into ownership and limited property rights (right of lien, servitude, real encumbrances, building titles and preemption rights). The *Land Reform Act*, adopted in 1997, has contributed to a functioning land market, which resulted in a

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<sup>41</sup> See id.

<sup>42</sup> *2001 Regular Report on Estonia's Progress Towards Accessions* (Brussels: Commission of the European Community, 2001) p 30.

<sup>43</sup> *Estonia Investment Profile 2001* (London: European Bank for Reconstruction and Development, 2001) p 11. "With the exception of the energy sector, the privatization and restructuring process is virtually complete in the industrial sector. The planned part privatization of the energy industry has halted in January 2002 and the GOE decided to keep the power plants under state control. The largest remaining state holdings are the Estonian Energy LTD and the Port of Tallin." See *2002 Regular Report on Estonia's Progress Towards Accessions* (Brussels: Commission of the European Community, 2002) p 40 & 83.

<sup>44</sup> *An Energy Overview of the Republic of Estonia* (Washington: Department of Energy, 2003) online at <http://www.fe.doe.gov/international/estnover.html>.

<sup>45</sup> *An Energy Overview of the Republic of Estonia* (Washington: Department of Energy, 2003) online at <http://www.fe.doe.gov/international/estnover.html>.

<sup>46</sup> *The Constitution of the Republic of Estonia*, Section 32 (1992).

sharp increase in land transactions reaching levels comparable with European market economies.<sup>47</sup>

## **B) Economic Developments**

The process of restoring private property rights was initially delayed by complex procedures for determining ownership, but is now mostly complete, with 86 percent of land returned to private hands and almost 60 percent of all land registered in the cadastre.<sup>48</sup> Foreigners were given the right to buy land, along with Estonians, in an effort to encourage FDI.<sup>49</sup> Both Estonians and foreigners now have the right to buy agricultural land as well.<sup>50</sup>

### **Assessment of factor**

The privatization program in Estonia was successful and is for the most part complete. Eighty percent of GDP is in the hands of the private sector. All sectors of the economy, including large infrastructure enterprises were included in the privatization process. The process was transparent and, while dominated by domestic investors, was also open to foreign investors. Land reform is complete. Both Estonians and foreigners are free to buy and sell agricultural and non-agricultural land, and there is a free market in land rights.

### ***Factor Five. The extent of government control over the allocation of resources and over the price and output decisions of enterprises.***

Decentralized economic decision-making is a hallmark of market economies, where the independent investment, input-sourcing, output and pricing actions of individuals and firms in pursuit of private gain collectively ensure that economic resources are allocated to their best (most efficient) use. Prices in such economies tend to reflect both demand conditions and the relative scarcity of the resources used in production.

An important measure of government control over production decisions and the allocation of resources is the degree to which the government is involved in the allocation of capital. Given that banks are important allocators of capital, the degree to which the State exercises control over the

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<sup>47</sup> 2002 Regular Report on Estonia's Progress Towards Accessions (Brussels: Commission of the European Community, 2002) p 40.

<sup>48</sup> OECD Reviews of Foreign Direct Investment: Estonia (Paris: Organisation for Economic Cooperation and Development, 2001) p 44.

<sup>49</sup> Estonia Country Commercial Guide FY2001 (Washington DC: US Commercial Service, 2001).

<sup>50</sup> The Economist Intelligence Unit; Country Profiles, Estonia, March 2002.

commercial banking sector is an important consideration.

The three relevant issues to consider under this factor for Estonia are price liberalization, commercial banking sector reform, and the degree to which individuals and enterprises can freely engage in business activities.

**1) Price liberalization**

**A) Legal Framework**

Prices were originally liberalized under the *Price Act* in 1989.<sup>51</sup> This law remained in force until it was repealed according to Article 40 of the *Law of Obligations Act* of 2002. The principles of free price formation are currently guided by the *Law of Obligations Act* and the *General Part of the Civil Code Act*.

**B) Economic Developments**

Wholesale prices were liberalized in 1990 and the majority of other prices were liberalized in 1992.<sup>52</sup> The share of administratively regulated prices has declined even more in the last few years. Currently, controlled prices account for about 15 percent of the consumer price index (“CPI”) basket.<sup>53</sup>

**2) Commercial banking**

**A) Legal Framework**

Under the *Law on the Central Bank of the Republic of Estonia*, the BOE is independent from all government agencies and reports only to the Parliament.<sup>54</sup> The BOE issues licenses for foreign

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<sup>51</sup> *The Republic of Estonia Price Act* (1989). This act was not translated into english.

<sup>52</sup> *The Economist Intelligence Unit; Country Profiles, Estonia*, June 1, 2001.

<sup>53</sup> *2002 Regular Report on Estonia's Progress Towards Accessions* (Brussels: Commission of the European Community, 2002) p 30. The most important regulated prices in the CPI are alcoholic beverages, tobacco, motor fuels and heating.

<sup>54</sup> Law No. RT 1 1993 28,498 *Law on the Central Bank of the Republic of Estonia*, Article 15 (1993, as amended in 2002).

investment in an existing or new bank.<sup>55</sup> The *Credit Institutions Amendment Act*, which came into force January 2002, brought Estonian's banking system into harmonization with EU accession requirements.<sup>56</sup>

Under the *Financial Supervision Authority Act*, which came into effect January 2002, the Estonian Financial Supervision Authority ("FSA") is responsible for oversight of the banking, insurance and securities sectors. The FSA is an autonomous body with a budget separate from the State and the BOE.<sup>57</sup>

The *Bankruptcy Law*, adopted in June 1992 and amended in February 1997, appears to be functioning adequately.<sup>58</sup> Under the law, bankruptcy is defined as the insolvency of the debtor as declared by court order, in which the debtor is unable to satisfy the claims of creditors due to a financial situation that is not temporary. A stronger *Bankruptcy Law* is expected to be adopted by the Parliament in 2003.

## **B) Economic Developments**

The BOE is independent from the central government and foreign investment is encouraged in all forms of commercial banks. These are necessary foundations for a competitive and open banking sector. Foreign enterprises own over 90 percent of Estonian banking sector capital and 98 percent of assets.<sup>59</sup> However, it should be noted that the banking sector is highly concentrated, with 3 banks owning over 95 percent of the total assets.<sup>60</sup>

Non-performing loans are not a problem in Estonia; the share of non-performing loans fell from

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<sup>55</sup> Law No. RT I 2002, 17,96 *Credit Institutions Act* (1999 as amended and consolidated in 2002 by the Credit Institutions Amendment Act).

<sup>56</sup> Estonia has been granted a transition period for the provision regarding the minimum guaranteed limit of deposits. In addition, with the adoption of the Law on Obligation and the Securities Market Act, a new interbank payment and settlement system, the Real Time Gross Settlement system and the Designated Time Net Settlement system, Estonia has improved alignment with the remaining acquis. Further improvement on money laundering as well as capacity of the financial intelligence unit has been requested by the Commission. See *2002 Regular Report on Estonia's Progress Towards Accessions* (Brussels: Commission of the European Community, 2002) p55.

<sup>57</sup> Update to the Report on the Observances of Standards and Codes, Securities Supervision (IMF 2002) p 1.

<sup>58</sup> *2002 Regular Report on Estonia's Progress Towards Accessions* (Brussels: Commission of the European Community, 2002) p 40.

<sup>59</sup> *Strategy for Estonia* (London: European Bank for Reconstruction and Development, 2002) p 18 & 22.

<sup>60</sup> See id at 22.



1.7 percent to 1.0 percent in 2000.<sup>61</sup> Banking intermediation to the private sector is growing, from 36 percent in 1999 to 41 percent in 2000.<sup>62</sup>

### **3) Entrepreneurship**

#### **A) Legal Framework**

The right of natural and legal persons to conduct economic activities is established by the *Constitution* and the *Civil Code*. Under the *Constitution*, Estonian citizens and foreigners have the right to engage in enterprise and to form commercial undertakings and unions.<sup>63</sup> The *General Principles of the Civil Code*, passed in June 1994 and entered into force on September 1, 1994, provides for the creation, rights, obligations and dissolution of legal persons, a necessary legal entity for private enterprise.<sup>64</sup> The *Principles* also provide for the general definitions for commercial transaction, agency, legal capacity and property, which all serve to form the basic foundation of contract law.

The *Law of Obligations Act* is a general part of the *Civil Code Act* and provides the basis for general contractual relations as defined by ‘offer’ and ‘acceptance.’ The law also provides for obligations arising from breach of contracts, such as unlawful infliction of damage, unjust enrichment, lack of authority to conduct business, public promise for reward and other grounds constituted by law.<sup>65</sup>

#### **B) Economic Developments**

Implementation of the Small and Medium-Sized Enterprises (“SME”) policy is the responsibility of the Ministry of Economic Affairs, which controls two business support foundations, Enterprise Estonia and the Credit and Export Guarantee Fund, both of which were created in 2001. Reforms to improve the business environment include revamping the licensing system and supporting managerial training activities. Sixteen regional business development centers were created to support the development of SMEs by offering information, training and business support at the local level. In January 2002, the GOE adopted the “Enterprise Estonia” policy paper, with the objectives to promote

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<sup>61</sup> See id.

<sup>62</sup> 2001 Regular Report on Estonia’s Progress Towards Accessions (Brussels: Commission of the European Community, 2001) p 31.

<sup>63</sup> *The Constitution of the Republic of Estonia*, Section 31 (1992).

<sup>64</sup> Law No. RT I 1994, 53, 889 *General Principles of the Civil Code Act*, Chapter 3 (1994 as amended).

<sup>65</sup> Law No. RT I 2002, 53, 336 *Law on Obligations* (2002). Prior to the enactment of the *Law of Obligations* in July 2002, Estonian contract law was governed by the 1964 *Third Part of the Estonian Soviet Socialist Civil Code*.

entrepreneurship, create new jobs and enhance competitiveness.<sup>66</sup>

The vast majority of enterprises in Estonia are small and medium sized. 30,612 enterprises were operating in Estonia in 2000, of which 75 percent were micro-enterprises, 19 percent small, 3 percent medium and 1 percent large. SMEs account for about half of the total work force. In addition, SMEs are the main source of new jobs.<sup>67</sup> Continued SME growth is crucial because of Estonia's high unemployment.

As with most transition economies, access to finance is the greatest obstacle to SME growth.<sup>68</sup> However, total credit exposure of Estonian banks to the SME sector has increased to about 40 percent.

### **Assessment of Factor**

The GOE no longer allocates resources in the economy and prices have been liberalized. The financial sector functions independent of the government and almost entirely in the hands of foreign investors. Entities are free to engage in business activities and are protected by law and in practice against government interference.

#### ***Factor Six. Such other factors as the administering authority considers appropriate.***

Under this factor, the Department can address any additional issues relevant to its consideration of market economy status. There are three main areas where Estonia has made progress that merit discussion but do not fit entirely into the factors addressed above: WTO membership, EU membership, and corruption. In all three areas Estonia has made considerable progress.

Estonia joined the WTO in November 1999 and is expected to join the EU in 2004, adopting the *euro* soon thereafter. Corruption is a relatively limited problem in Estonia.<sup>69</sup> The *Anti-Corruption*

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<sup>66</sup> 2002 Regular Report on Estonia's Progress Towards Accessions (Brussels: Commission of the European Community, 2002) p 84-85.

<sup>67</sup> Strategy for Estonia (London: European Bank for Reconstruction and Development, 2002) p 24.

<sup>68</sup> 2001 Regular Report on Estonia's Progress Towards Accessions (Brussels: Commission of the European Community, 2001) p 32.

<sup>69</sup> Corruption index 2001 (Transparency International, 2001) online at <http://www.transparency.org/cpi/2001/cpi2001.html#cpi>.

*Act*, enacted in March 1999, provides the grounds for prevention and prosecution of corruption.<sup>70</sup> The act also includes a Code of Ethics for public officials. Additionally, the *Penal Code*, recently enacted in September 2002, also provides for the criminal liability of officials and legal persons.<sup>71</sup>

## ASSESSMENT

Although section 771(18)(B) of the Act enumerates six factors that the Department must consider in determining whether a country operates on market principles, the statute provides no direction or guidance with respect to the relative weight that should be placed on each factor in assessing the overall state of the economy. As discussed above in the “Analytical Approach” section, the Department considers whether the facts, as applied to the statutory factors, demonstrate that the economy is generally operating under market principles.

In the case of Estonia, there are many positive developments that support the conclusion that Estonia has a market economy. Estonia is a WTO member and is expected to join the EU next year. As a result, Estonia has fully liberalized its economy, and its legal structure and economic practice have been made largely EU consistent. In particular, Estonia’s currency is fully convertible for both current and capital account transactions. The currency’s exchange rate is set by a CBA in an independent and transparent manner. Wages are market-based and reflect the relative bargaining power of labor and management, which vary with local market conditions and the industry sector in question. Estonia is one of the most open central European countries to foreign investment, and FDI inflows have been one of the highest in the region. Privatization and land reform in Estonia are for the most part complete, having been managed in a transparent manner. Prices in Estonia have been liberalized, and the government no longer controls the allocation of resources. Moreover, entities are free to engage in business activities, and are protected by law and in practice against government interference. On the basis of the comprehensive economic and legal reforms discussed above, the Department believes that it can use prices and costs within Estonia for purposes of its antidumping analysis.

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<sup>70</sup> Law No. RT I 1999, 16, 276 *Anti-Corruption Act* (1999 as amended in 2002).

<sup>71</sup> Law No. RT I 2001, 16, 364 *Penal Code* (2002).

## RECOMMENDATION

Based on the evidence on reforms in Estonia to date, analyzed as required under section 771(18)(B) of the Act, we recommend that the Department determine that (1) revocation of Estonia's non-market economy status under section 771(18)(A) is warranted and (2) Estonia has operated as a market-economy since January 1, 2003.

Agree \_\_\_\_\_ Disagree \_\_\_\_\_

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Faryar Shirzad  
Assistant Secretary  
for Import Administration