August 14, 1992

Dear Mr. Camdessus:

The Government of the Republic of Estonia has begun the process of transforming Estonia into a fully fledged market economy. A series of important steps have been taken to that end over the course of the past year, including the liberalization of virtually all prices, maintenance of a prudent fiscal policy, extensive freeing up of the external trade and payments system, and the introduction of a national currency, the kroon, with broad current account convertibility. These policies have been introduced in an environment characterized by a sharp contraction of output, brought about by trade dislocations with Russia and other traditional trading partners and the move to near world market prices for energy and other raw materials. The continued effort to restructure and reform Estonia's economy in the face of the adverse external circumstances requires a strong stabilization program.

The Government of Estonia believes that the policies set out in the attached Memorandum of Economic Policies will be adequate to maintain internal and external stability in Estonia and to support the continued restructuring of the economy. This will make a key contribution to helping maintain confidence in the kroon and to creating preconditions for sustained growth in the medium-term. In support of these policies, the Government hereby requests a twelve month stand-by arrangement in the amount of SDR 27.9 million. The Government will provide the Fund with such information as it may request for the purposes of monitoring progress under the program supported by the stand-by arrangement, and will remain in close consultation with the Fund, in accordance with the Fund's polices on such consultations. Furthermore, we stand ready to take any additional measures that may become necessary to achieve the aims of the program. Moreover, we will complete with the Fund three reviews of economic developments and policies under the program, the first by November 15, 1992, the second by February 15, 1993, and the third by May 15, 1993. The quantitative performance criteria for the first half of 1993 will be specified at the time of the second of these reviews.

Sincerely,

/s/
Tiit Vähi
Prime Minister

/s/
Siim Kallas
Governor
Bank of Estonia

Estonia - Memorandum of Economic Policies

I. Introduction

1. The Estonian people have traditionally strived for democracy and national independence. However, the return of a genuinely independent democratic government in Estonia was only made possible through the process of liberalization in the former Soviet Union and with the aid of the democratic countries of the world. The return of democratic government in Estonia, which has been strengthened by the implementation of the new constitution, has established the political legitimacy necessary to move decisively toward a market economy.

2. The Estonian economy, as an integral part of the former Soviet economic structure, has been subject to rigid central planning for the past 50 years. During this period, substantial changes were forced on the Estonian economy, based on the political and economic imperatives of the Soviet Union, that bore little or no relation to Estonia's natural economic interests. As a result, substantial economic, environmental and sociodemographic imbalances have accumulated, and remain a heavy burden on the economy. These imbalances are mainly responsible for the acute economic crisis now faced by Estonia, which is characterized by sharply falling output, a high rate of inflation, and declining living standards. In addition, since late 1991, there has been a severe terms-of-trade shock occasioned by the shift of much of Estonia's trade to world market prices, especially trade in petroleum products,

which has led to the emergence of a large financing gap in the balance of payments. Economic policy-making in this setting has been further complicated by the difficulty of managing the rapidly changing trade and payments relations with the CIS states, which remain Estonia's main economic partners.

3. In the existing political and economic environment, the only viable route to restoring economic growth and price stability is to move decisively toward a market economy. To that end, the Government has elaborated a stabilization and reform program that has been progressively implemented since independence, and on the basis of which the Government requests the financial support of the International Monetary Fund in the form of a stand-by arrangement. The Estonian authorities hope that this bold commitment to a market economy will also receive timely and material support from the international financial community.

II. The Estonian Economy in Early 1992

Introduction

4. During the first half of 1992, real GDP continued to decline, falling by an estimated 30-35 percent relative to the same period during the previous year. The cumulative decline in GDP since 1990 has had a severe impact on the living standards of the population. For the first several months of 1992, output was also constrained by problems in effecting interrepublican payments and the virtual halt in trade with Russia, especially the difficulties in maintaining adequate fuel deliveries. By mid-year, fuel supplies were restored to minimum operational levels under the March 1992 trade agreement with Russia and by purchases from the West. The external current account in convertible currencies remained broadly balanced during the first half of 1992 due to the compression of imports in the absence of adequate external financing. Trade with the CIS appears to have been in deficit, as reflected in a build-up of correspondent account liabilities, especially with respect to Russia. Officially registered unemployment remained low through June 1992. However, the decline of employment in state enterprises of 8 percent during the first half of 1992 suggests that adjustment in the labor market has started and that open unemployment may rise sharply in the period ahead. The Government's policy during this period has aimed at accelerating the liberalization of the economy, containing the budget deficit that emerged in March, and preparing for the currency reform.

Liberalization of the economy

5. Over the past two years, Estonia has moved rapidly to liberalize prices and to reduce or eliminate subsidies. Consequently, the price level has risen rapidly since 1990. Moreover, inflation in late 1991 accelerated as Russia began to increase sharply the price of energy exports, which had until then remained at extremely low levels. The monthly rate of inflation reached an average rate of 80 percent in January and February 1992, as Russia continued to raise energy prices, which moved to near world market levels during this period, and concurrently introduced a widescale liberalization of prices. The monthly inflation rate subsequently declined to an average rate of 7.5 percent in April and May, before picking up again in June to 11 percent (reflecting the lagged effect of the reduction of subsidies in May). Since the introduction of the kroon on June 20, prices increased by 24 percent, as the conversion process was used as an opportunity to raise prices and also reflecting the concurrent increase in the VAT rate. Wages continued to lag price developments in 1991 and the first half of 1992. Real wages may have declined by a third in 1991 and by even more in the first half of 1992.

6. Although the Government has begun the process of restructuring and privatization with the 1989 Law on Enterprises and the 1991 Law on Privatization of State Owned Trade and Service Facilities, the process of privatization has been confined mainly to smaller enterprises, of which about 33 percent had been privatized by June 30, 1992. At the same time, a total of seven larger enterprises have been privatized to gain experience with the process. Nevertheless, the benefits of even this limited privatization have been evident as prices in the private sector (mainly private markets for agricultural produce and smaller service sector establishments) have quickly reflected changes in demand and where the availability of commodities has been better than elsewhere. In light of this experience, and with the objective of accelerating privatization and creating a strong foundation for a market-based economy, legislation was passed (i) in April 1992 that initiated the privatization of Estonia's housing stock; (ii) in May 1992 that raised the maximum net worth of smal enterprises available for privatization from the equivalent of EEK 50,000 EEK 600,000; and (iii) in June 1992 that provided a formal mechanism for liquidation of bankrupt enterprises and banks.

7. Privatization has also been hampered by the process of restitution and compensation for property seized after the Soviet takeover in 1940. Registration of restitution and compensation claims was completed for all residents of Estonia on January 17, 1992. Individuals that are not residents of Estonia, but are eligible for Estonian citizenship, were given an indefinite period during which to register restitution and compensation claims. After restitution, it is estimated that the state will own up to 2 percent of the land and 20 percent of residential dwellings, while local authorities will own 0.5 percent and 10 percent, respectively.

8. To reduce the scope for direct government involvement in the economy, obligatory state orders were eliminated as of January 1, 1992, except where such orders were required to fulfil1 obligations under barter trading arrangements and other agreements with former Soviet states.

Fiscal policy

9. The Estonian authorities, at both the central and local levels, have remained committed to balanced budgets. Thus, despite substantial declines in output and real incomes, overall general government budget surpluses were recorded in both 1990 and 1991, and a balanced position was maintained through February 1992. This success in avoiding budget deficits can be attributed to expenditure restraint, especially the reduction in subsidies, as well as to changes in the tax structure made since 1990, particularly the modernization of the income and corporate taxes, and the introduction of the VAT, which together have increased the tax system's responsiveness to growth in nominal income. However, in March 1992 the budget moved sharply into deficit as milk subsidies were reintroduced and heating subsidies rose reflecting higher imported energy prices. Moreover, there has been a worrisome increase in corporate and value-added tax payments arrears, which amounted to about 8 percent of total assessed taxes. The Government took remedial measures in May 1992, mainly through the elimination of milk and heating subsidies as well as advanced profit payments by selected enterprises, which returned the general government accounts to balance by mid-1992.

Monetary policy

10. In the period since independence, and up to the introduction of Estonia's national currency on June 20, 1992, monetary policy was mainly focused on the development of a two-tiered banking system and on measures to alleviate shortages of ruble banknotes that emerged in late 1991 and persisted through mid-June 1992. The Bank of Estonia (the Bank) was established on December 28, 1989, and the effective merger of the Tallinn branch of the Gosbank with the Bank, which was made official on January 1, 1992, has now been completed. Furthermore, although as a legal matter the Bank of Estonia's commercial banking functions (confined mainly to foreign operations of the Vneshekonombank absorbed by the Bank in 1991) were transferred in their entirety to the Northern Estonian Bank in June 1992, as a practical matter, a substantial overlap in management, administration and operations remains. Meanwhile, the commercial banking sector has grown substantially and comprised 41 licensed commercial banks as of June 30, 1992, plus the Savings Bank and the Agrobank. The Bank has recognized the weaknesses in the accounting, settlement, and bank supervision systems and is taking steps to strengthen these systems with technical assistance coordinated by the Fund.

11. The growth rate of broad money during the first half of 1992 was only 55 percent, 1/ or considerably lower than the rate of consumer price inflation over the same period (450 percent). Total domestic credit declined sharply in real terms during this period as credit to state enterprises was severely constrained, thereby partly contributing to the recent growth of inter-enterprise arrears. Despite the high rate of inflation, interest rates remained at relatively low levels and thus were primarily negative in real terms. After the increase in Russian interest rates in April 1992, and in anticipation of the currency reform, interest rates in Estonia followed suit, with lending rates for maturities up to six months at private commercial banks rising to a level of about l00-140 percent in June.

12. The Government had already announced in the late 1980s its intention to introduce its own national currency, the Estonian kroon. The kroon was made the sole legal tender in Estonia on June 20, 1992 after the Government had formulated a macroeconomic stabilization program and agreed on workable arrangements for settling trade and payments with Russia and the Ukraine. The kroon was introduced in the context of a modified currency board and was fixed to the deutsche mark at an

exchange rate of EEK 8 - DM 1. The only convertibility commitment assumed by the Bank was to stand ready to convert cash and reserves of commercial banks at this rate (with no buy-sell spread). Exchange rates for other currencies are published daily by the Bank of Estonia for the information of commercial banks and to establish buy-sell limits for foreign exchange trading. 2/ At the outset of the reform, foreign exchange holdings by the Bank (US$55 million) were adequate to capitalize the currency board under the convertibility commitment described above. Pursuant to the regulations governing currency board operations, future changes in the kroon note issue and commercial bank reserves held with the Bank of Estonia will be fully backed and reflected in the currency board's reserves. At the same time, the Bank of Estonia fully guaranteed the deposits of the Savings Bank, pending its reorganization. 3/ Immediately following the reform, average commercial bank lending rates remained at relatively high levels--ranging from 50-100 percent--as banks strived to adjust to the new monetary and credit environment.

1/ Excluding foreign currency deposits.
2/ For this purpose, the Bank collects cross-rates from the Frankfurt interbank market at its daily fixing.
3/ Before independence, all Savings Bank deposits were channeled to Gosbank (Moscow) through the local republican Gosbanks. Since January 1, 1992, the counterpart deposits with Gosbank (Moscow)--now the Central Bank of Russia--have been frozen. Savings Bank deposits were included in the amount covered by the currency board because these represent direct liabilities of the Bank of Estonia and because there are no counterpart liquid claims held by the Savings Bank.

External policies

13. External policy in Estonia since independence has been limited to freeing the foreign exchange market and implementing a commercial policy directed at ensuring adequate supplies of critical imports in the first instance, and more generally, seeks to free inter-enterprise trade to the greatest extent possible. With the introduction of the kroon, the Government intends to continue these policies, and to that end has made broad current account convertibility and limited capital account convertibility key elements in the currency reform package.

14. As from February 1, 1992 through June 20, 1992 (the date of the currency reform), commercial banks had been free to set their own exchange rates for cash transactions with the general public (with the official Bank rate established weekly in line with these commercial bank rates), while resident enterprises had been free to buy and sell foreign exchange at auctions supervised by the stock exchanges. Since the currency reform, the Bank of Estonia has decreed that commercial banks are limited to a buy-sell spread of plus or minus 1 percent; banks are otherwise free to set their own buying and selling rates as they wish - provided that trades are within a band defined as a range of plus or minus 3 percent of the central rate published daily by the Bank of Estonia. Although foreign exchange auctions may be conducted after the currency reform, with participation initially confined to commercial banks, these auctions have so far been limited to the sale of rubles against U.S. dollars. Enterprises may participate indirectly at these auctions by using commercial banks as agents.

15. The loss of confidence in the ruble, and the attendant disruptions in interrepublican trade, led the Government to seek bilateral trade agreements with former Soviet republics that traditionally supplied Estonia with vital intermediate inputs, and attempted to control exports of its own products by imposing an export licensing system, directed primarily at trade with the former Soviet Union. On February 1, 1992 Estonia lifted most export controls on trade (with the exception of certain strategic goods), and further liberalized export controls on June 29, 1992; 1/ it currently maintains a largely tariff-free regime. Trade with Russia and other former Soviet republics fell sharply in early 1992, mainly reflecting difficulties in implementing the new export licensing system in Russia. The Government responded by negotiating a bilateral trade protocol with Russia on February 26, 1992, which has had only mixed success in restoring trade. Negotiations began in July with Russia on a new trade agreement that would bring about a further liberalization of trade between these republics. As regards trade with the West, free trade agreements have been signed with Finland, Sweden and Norway and a nonpreferential trade agreement was signed with the European Community in May 1992. Details of these trade agreements have yet to be agreed.

16. Estonia also negotiated agreements with Russia and the Ukraine on a system for the settlement of interrepublican payments under the kroon regime. On June 20, agreement with Russia was reached

whereby existing correspondent accounts were closed and all subsequent payments were to be channeled through new accounts, which were opened with initial technical balances equivalent to rub 250 million available to Estonia and EEK 25 million available to Russia. Meanwhile, it was agreed to settle at a later date the issue of the repayment of Estonia's debit balance on its correspondent accounts with Russia, amounting to about rub 4.0 billion. Broadly comparable arrangements for settlement of interrepublican payments with a number of other former Soviet republics are currently being negotiated.

17. Although Estonia has traditionally run trade deficits, in 1991 it is estimated that disruptions in interrepublican trade (which had a greater effect on imports than exports), together with a terms-of-trade improvement reflecting the differential pace of price liberalization, resulted in a current account surplus with other former Soviet republics equivalent to about rub 1.1 billion; trade in convertible currencies in 1991 showed a deficit. The question of Estonia's share of the external debt of the former Soviet Union remains to be settled. The Government has begun discussions with Russia on this matter in the context of more general negotiations regarding the disposition of property claims in Estonia and abroad. It is expected that these negotiations will be concluded by late 1992 or early 1993.

18. The Government believes that the policies and measures outlined above represent important steps in the direction of moving Estonia toward a market economy. It is recognized, however, that additional strong measures will be necessary to consolidate gains already made, to accelerate the transition to a market economy, and to obtain the external finance necessary to ensure a successful completion of the transformation process. The Government is committed therefore to press ahead forcefully and speedily with its program of stabilization and reforms. This will involve, in the first instance, setting forth a comprehensive economic program for the second half of 1992, together with a broad framework for carrying forward the process in 1993.

1/ Export controls consist primarily of quotas; they do not apply to trade with countries with which Estonia has concluded free trade agreements.

III. The Government's Program for July 1, 1992 - June 30, 1993

Introduction

19. The Government's main objective for the second half of 1992 and the first half of 1993 will be to adjust quickly to the terms of trade shock, to stabilize prices, and to accelerate the process of privatization and restructuring, thereby creating the preconditions for sustained growth. It is intended to make a fundamental improvement in the external situation with a view to reducing dependence on foreign financing over the longer term. To that end, the Government has put in place a comprehensive stabilization and reform program to create the vital preconditions for ensuring the stability of the kroon in the period ahead. In face of the strong destabilizing influences arising both from the process of economic transformation itself and from the trade disruptions and the terms of trade shock, the program will aim at limiting the decline in output and the increase in unemployment, and a build-up of international reserves to instil1 confidence in the kroon. The financing requirement implied by these targets is considered financeable from external sources and consistent with the economy's longer term debt servicing capacity. Building on the expected success of the program for the remainder of 1992, we intend to persevere with our restructuring and stabilization efforts in 1993.

20. The main elements of our stabilization program are as follows:

(i) completion of the price reform process;

(ii) restrictive fiscal policies aimed at balancing the general government accounts (including the state budget, and the budgets of the extrabudgetary funds and the local authorities);

(iii) adhering firmly to the provisions of the laws and decrees associated with the currency reform;

(iv) an incomes policy aimed at containing excessive wage increases so as to avoid an inflationary spiral;

(v) further liberalization of the exchange and trade system; and

(vi) a comprehensive structural adjustment effort covering privatization, improvement of financial discipline of enterprises, financial sector reform, fiscal reform, improvement in the operation of the social safety net, and restructuring or closure of nonviable enterprises and banks.

Price liberalization and inflation

21. The Government largely completed the price liberalization process prior to the implementation of the currency reform. Accordingly, on June 19, 1992 the commodities still subject to control were mainly limited to those produced by state enterprises and included land, natural resources (including oil shale), precious metals and gems, electricity, natural gas, liquid fuel, wood products, flour, cereals, grain, bread, sugar, macaroni, tobacco goods, vodka and liquors, postal and telecommunications services, transportation services, medicines and returnable bottles. A number of services provided by municipalities and public enterprises, including rent, public utilities, and public transportation, also remained subject to control. The Government recognizes the need to complete the price liberalization process as soon as possible, and to that end, it is our intention to remove price controls on flour, cereals, grain, bread, sugar, macaroni and returnable bottles, no later than October 15, 1992. On July 9, 1992, the Government had already removed controls on state enterprise profit margins imposed by local authorities, except for those enterprises owned by local authorities. The remaining price controls will remain temporarily in place in cases where the authorities judge that monopoly power on the part of producers could lead to abuse. Meanwhile, the Government will continue to refrain from subsidizing any consumer goods or services, or providing subsidies to state enterprises (except for selected public utilities).

22. The Government considers that rapid progress in the alignment of domestic energy prices with international prices is essential if energy consumption is to be rationalized. To this end, the prices of natural gas, electricity, heating and hot water were raised by an average of 25 fold since December 1, 1991. Furthermore, subsidies on heating and hot water were eliminated on May 1, 1992 and average prices for all heating, natural gas, oil shale, and electricity were adjusted to reflect full operating cost pricing on May 1, 1992. Retail prices of gasoline and diesel have been increased on several occasions, most recently on May 30, 1992 to a level about 70 times higher than that of a year ago; the Government's policy with regard to fuel pricing has been and will continue to be to ensure a full pass-through of all costs to the retail level. By October 31, 1992, the Government will also initiate a study of tariff setting procedures for municipal and public enterprise services-- including public transportation-- in order to phase in cost-based pricing (but allowing for some improvements in operating efficiency) as soon as possible so as to avoid the need for substantial public subsidies and a drain on the general government budget.

23. It is expected that the further price liberalization measures will result in some additional price increases in the coming months, although these should be moderate in relation to the experience during the first half of 1992. However, with the consistent implementation of firm financial and incomes policies, the average monthly rate of inflation is expected to decline to about 4 percent in the last quarter of 1992, as compared to an average monthly rate of over 30 percent during the first half of 1992 (i.e., prior to the currency reform).

Fiscal policy

24. Fiscal policy will play a crucial role in adjusting the economy to the large deterioration of the terms of trade and supporting the new currency. Strong measures have been taken during the first half of 1992 to ensure that the general government accounts returned to balance by mid-1992, including the abolition of consumer subsidies and the requirement that certain profitable public enterprises make advance profit distributions to the budget.

The Government recognizes the crucial importance of keeping the general government accounts in balance, mainly to avoid the threat to the kroon of reliance on bank financing of deficits prior to the evolution of a market in Government obligations. Accordingly, for the second half of 1992, the Government has drawn up a budget that is balanced, and also provides for a prudential cushion to meet unforeseen expenditure contingencies. Revenue-raising measures in support of maintaining a prudent fiscal stance through the remainder of 1992 were adopted by a decree of the Monetary

Reform Committee and include: (i) raising the VAT rate from 10 percent to 18 percent, effective June 20, 1992; (ii) introducing a new top marginal rate of personal income tax of 50 percent for taxable incomes in excess of ten times the minimum wage, effective August 1, 1992; and (iii) unifying the corporate income tax at a single rate of 35 percent (as compared to the multi-rate structure with an average rate of 27 percent in effect earlier), effective June 20, 1992. Although Parliament did not endorse the budget for the second half of 1992 when it convened briefly in early July, it nevertheless underscored the importance of maintaining overall fiscal balance for the remainder of 1992. To further strengthen the budget, the Government will shortly propose to Parliament a special ad valorem excise tax of 10 percent on high octane gasoline and 1 percent on other fuels (before VAT).

25. The Government is determined to undertake further measures to ensure budgetary efficiency and stability in 1993, including maintenance of a balanced budget and a return to an annual budget cycle. At that time, the Government will also consider implementing the following measures: (i) to rationalize the personal income tax rate structure to take into account, inter alia, the recent increases in the minimum wage, the introduction of the new top rate and the unification of the corporate income tax rate; (ii) to extend the coverage of the VAT to the import stage and zero rate all exports; (iii) to rationalize the structure and administration of excise and customs duties; (iv) to take steps to introduce a survey-based real property and land tax to be managed by, and for the benefit of, local authority budgets (as part of the restructuring of local authority finances); (v) to change the financial structure of the Social Security Fund so as to make it more transparent, by transferring responsibility for payment of nonpension related benefits to the state and local budgets; (vi) to review the structure of tax exemptions granted to enterprises; (vii) to incorporate all but two extrabudgetary funds--the social security and medical insurance funds--into the state budget; (viii) to prepare a consolidated general government budget that explicitly sets out the economic classification and overall balance of expenditures and revenues and their financing; and (ix) to introduce a system of cost-sharing for education and health benefits.

26. To improve the implementation and monitoring of fiscal policy, the Government formed in June 1992 a foreign grant (cash and commodity) and loan monitoring unit at the Ministry of Finance. To the same end, it will also by October 31, 1992 complete a study of revenue authority and expenditure responsibility of local governments; pending completion of this study, any borrowing by local governments would require prior clearance by the Ministry of Finance. A review of civil service staffing and remuneration policy will be completed by December 31, 1992.

27. In 1992, financing from the banking system of the general government (including local authorities) will be confined to smoothing seasonal fluctuations in revenues and expenditures. 1/ Taking account of seasonal factors, the net deposit position of the general government with the banking system, as defined in Appendix I, which was EEK 150 million on June 30, 1992, shall not fall below EEK 105 million as of September 30, 1992 nor EEK 150 million on December 31, 1992.

28. The Government is committed to support structural fiscal reforms consistent with keeping the evolution of public expenditure in the medium term in line with the evolution of tax revenues and of noninflationary financing from domestic and foreign sources. Specific structural measures in the fiscal area would include strengthening of tax administration and collection by, inter alia, revising tax forms, introducing a taxpayer identification number, extending the withholding system to cover interest paid by banks and individuals, and clarifying the penalties imposed on non- filing and nonpayment. A particular effort will be made to ensure that the emerging private enterprise sector is fully captured within the tax base. For this, the Government will seek technical assistance from the Fund and other sources.

1/ Under the provisions of the currency reform, any general government financing would be confined exclusively to borrowing from commercial banks.

Social safety net

29. The transition to a market economy will place an unusually heavy burden on the social security system, and the Government will keep the existing system under review to ensure that government assistance is channeled effectively to the most vulnerable groups of the population, while taking budgetary constraints into account. In particular, by December 31, 1992, the Government will (i)

establish a poverty line; (ii) review the categories of groups eligible for state assistance to gauge the appropriate scale of relief; (iii) design a system of retraining for displaced workers and provide the necessary financing for this effort; and (iv) rationalize the pension system (including raising the retirement age as of January 1, 1993). The Government will seek technical assistance from the Fund and the World Bank in the design of these programs.

Monetary policy and currency reform

30. The introduction of the kroon in the context of a currency board operated by the Bank of Estonia will provide Estonia with a stable monetary environment within which stabilization and reform efforts can be implemented expeditiously.

31. Monetary policy will be drastically circumscribed. Any increases in the total of the kroon note issue plus commercial bank deposits with the Bank of Estonia, will by virtue of the operation of the currency board, be backed 100 percent by liquid international reserves. The Bank will not have the capability to extend credit to the Government. Commercial banks facing transitory liquidity shortages will be able to address these through the use of their reserve deposits with the Bank of Estonia, but increasingly severe penalties will apply in circumstances where these fall below required levels.

32. The Government of Estonia is committed to ensuring that conditions favorable for the operation of the currency board are realized. To that end, the commercial banking activities of the Bank of Estonia have already been separated from its central banking functions to establish a genuine two-tier banking system on June 17, 1992. The Bank will also prepare by August 15, 1992 the following three balance sheets reflecting positions as of July 31, 1992 (and for each end-month thereafter); (i) for currency board operations (the "Issue Department"), (ii) for the remainder of the Bank's operations (the "Banking Department"), and (iii) for the Savings Bank. It will segregate from the balance sheet of the currency board all operations that fall outside the limited scope of the currency board (i.e., issuing currency and holding commercial bank reserves, all 100 percent backed by foreign reserves).

33. Meanwhile, the Government will conduct fiscal policy in the prudent manner set out in paragraphs 24 and 25 above and will accelerate privatization and structural reform efforts. For its part, the Bank already enforced in early June 1992 full compliance of existing commercial bank reporting standards and has required that banks report their positions on the basis of a standardized balance sheet. It will also work to further streamline and modernize Estonia's financial institutions by (i) improving the clearing system for payments within Estonia by September 30, 1992 so that all domestic payments clear within two business days of receipt of instructions; (ii) submitting to Parliament by November 30, 1992 a new charter of the Bank of Estonia, Central Bank Law and Commercial Banking Law; and (iii) implementing an internationally accepted bank accounting plan by March 31, 1993. Furthermore, to make all bank supervision procedures operational and ensuring that all banks adhere to established prudential guidelines, the Bank will arrange for the approval, publication and implementation of adequate licensing guidelines for commercial banks. It will also ensure that (i) approval and publication of supervisory regulations on asset classification standards, provisioning for problem loans, capital adequacy requirements, asset concentration guidelines, lending limits and foreign exchange exposure limits will be implemented by November 30, 1992; (ii) approval and publication of enforcement procedures and penalties of said regulations will be completed by January 1, 1993; (iii) capability to perform off-site supervision, including adequate staffing at the Bank of Estonia, will be achieved by January 31, 1993; and (iv) procedures manual and implementation of on-site monitoring will be effected by March 31, 1993.

34. The Government recognizes that an efficient financial system is characterized by a system in which interest rates reflect supply and demand and are an important element in individual borrowing and lending decisions. Moreover, within a currency board framework, changes in interest rates are the principal mechanism signaling shifts in the demand and supply for kroons. To ensure that interest rates play their vital role in achieving rapid adjustment to changing circumstances, commercial banks will remain free to set interest rates for credits and deposits based on market conditions. However, given the current structure of the banking system, particularly the close ties between banks and enterprises, temporary limitations on interest rate margins may be imposed, in consultation with Fund staff, to prevent banks with large portfolios of nonperforming loans from using excessive spreads to recapitalize themselves. As a performance criterion, the Bank of Estonia will ensure maintenance of (i) full foreign reserve backing for the currency board's liabilities at the end of each weekly reporting

period and (ii) reserve requirements by commercial banks consistent with Bank of Estonia regulations (for further details, see Appendix II).

35. The Government recognizes the importance both to the banking system and the economy as a whole of the need to rapidly restructure the banking system to eliminate the burden of nonperforming loans on the financial sector and to address the growing problem of inter-enterprise arrears in Estonia. To that end, by November 30, 1992 at the latest, plans will be developed for restructuring and privatizing the banking system, and will specifically address the issue of nonperforming loans and include a review of the state of inter-enterprise arrears and a plan for how to deal with them.

Incomes policy

36. The Government considers a market-based system of wage determination that will encourage labor mobility and productivity to be a highly desirable objective in the medium term. However, in the meantime, to reduce inflationary expectations, contain a possible wage-price spiral, and avoid the decapitalization of state enterprises through excessive wage increases, the Government introduced an incomes policy effective July 1, 1992. 1/ To allow time for preparing the details of this policy, wage compensation was frozen in July. Thereafter, specific guidelines were established to limit the percentage increase for average employee compensation in the state sector (including local authorities) and state enterprises for the period August-December 1992. Similar guidelines will be issued for every succeeding calendar quarter thereafter. The guidelines for August-December 1992 were set to equal the targeted increase in the consumer price index during the corresponding period, also taking into account special factors such as increases in bread, gas and heating prices. The Government's aim is to prevent any further decline in real wages and to that end the guidelines will allow gross incomes to rise in line with inflation. In support of this policy, a new consumer price index will be introduced by August 31, 1992. For the first period, wage increases are to be granted in September 1992 and again in November 1992. Wage increases in succeeding periods will be granted in the middle of each calendar quarter. Guidelines for wage increases will be the same for all governmental administrative units and state enterprises and there would be no exemptions. There will be no restriction on the level of any individual's wage; only the percentage increase in the average wage in each enterprise or administrative unit will be limited. If in any calendar quarter the actual increase in the consumer price index turns out to be substantially different from the expected increase on which wage limits were based, any such deviation will also be taken into account when the acceptable increase in the average wage compensation for the following incomes policy period is established. When evaluating the need for such an adjustment, attention shall be paid to terms-of-trade developments and external competitiveness in the enterprise sector. For this, the Government will review wage and price developments for the first time in November. In the first instance, private enterprises would be exempt from this policy.

37. The Government's projection for inflation during the period August-December 1992 is 26.5 percent. Accordingly, the guideline for September 1992 provides for a maximum increase in average wages of 12 percent, to be followed by a further maximum increase in November 1992 of 13 percent. The guidelines for increases in subsequent periods will be established with the cooperation of Fund staff.

38. Wage increases above this ceiling will be penalized by an excessive wages tax. This tax will be levied on enterprises at the end of January 1993, and at the end of each three monthly period thereafter, for any excess of the wage bill- -adjusted for the number of workers--beyond the permissible amount during the immediately preceding period at progressive rates: 200 percent for an excess of between 1 percent and 3 percent, and 400 percent for an excess of more than 3 percent.

1/ For a detailed description of the incomes policy, see Appendix III.

External sector policies

39. The Government recognizes that, in the transition to a market economy, the removal of remaining exchange and trade restrictions is a central part of the strategy for introducing a rational structure of relative prices, for exposing domestic monopolies to competition, and for alleviating supply bottlenecks. These measures will work together with price liberalization and privatization to create a

competitive environment and establish appropriate market signals to guide production and investment choices by decentralized decision makers. A credible currency board operation will also serve as an important element in maintaining confidence in the kroon and in Estonia's financial integrity.

40. With the introduction of the kroon, the Government adopted a liberal exchange rate system providing for broad current account convertibility, whereby unlimited amounts of kroon may be converted into foreign exchange at authorized banks by resident-individuals and by residents-entities upon presentation of import or payments documentation. Limited capital account convertibility was also provided, whereby individuals and enterprises could keep in Estonia, and freely use until January 1, 1993, balances in their foreign exchange accounts outstanding as at June 20, 1992 (but not add to such balances). Meanwhile, full surrender of foreign exchange by exporters is required within a period of two months.

The Government will review the relevant decrees providing for current and capital account convertibility in due course with a view to further liberalizing the exchange system, thereby reducing or eliminating the risk that "black markets" may emerge for the kroon with rates significantly different from the official exchange rate established by the Bank of Estonia.

The foreign investment law in effect before the introduction of the kroon, allowing the full repatriation in hard currency of capital involved in foreign direct investment, has been maintained. For prudential purposes, limits have be imposed on the foreign currency exposure of domestic banks whereby each bank licensed for foreign exchange operations is permitted an overall open position no greater than 30 percent of its capital and reserves, or an open position with respect to any single currency of 10 percent of its capital and reserves. All foreign exchange holdings of the Government have been converted into domestic deposits with commercial banks as from June 20, 1992. The foreign currency budget has also been abolished as of the same date and the Government will henceforth meet its foreign exchange needs through purchases at the prevailing market exchange rate.

The Government and the Bank of Estonia recognize that the operation of a currency board is inconsistent with central bank intervention to maintain or influence exchange rates in the interbank or auction market, and will therefore refrain from such intervention. The exchange rate for the kroon will rarely depart significantly from the Bank of Estonia's central rate owing to the existence of the Bank's guarantee to exchange cash or commercial bank reserves with itself at that rate.

41. There are currently virtually no licensing requirements for imports. All export quotas and licensing requirements were removed as of June 29, 1992, except in the case of alcohol, tobacco, grain, cables, peat, shale, sand, clay, limestone, dolomite and hides, for which restrictions will be removed as of January 1, 1993, unless such licensing is deemed by the Government to be necessary for reasons of security and health. In the case of ferrous and nonferrous metals, export taxes have been imposed instead. Export taxes also apply to rapeseed oil, antiques, and selected cultural items. In any event, the Government does not intend to introduce new, or intensify existing, exchange restrictions, introduce or modify multiple currency practices or to impose or intensify any import restrictions for balance of payments purposes, during the period of the arrangement.

42. Payments and transfers will generally be settled in convertible currencies. However, selected bilateral agreements, some of which may entail restrictions on payments and transfers for current international transactions and, in some cases, multiple currency practices, are expected to remain in effect or be renewed. It is the Government's intention to phase out these arrangements as soon as practicable with a view to establishing the most liberal possible conditions for trade between enterprises in Estonia and the former Soviet republics. To that end, a customs union with Latvia and Lithuania is currently under negotiation and Estonia is engaged in discussions that could lead to a free trade agreement with the CIS. During the period of the arrangement, the Government will not conclude new bilateral payments agreements inconsistent with Article VIII of the Fund's Articles of Agreement.

43. The Government intends to conduct Estonia's international economic relations on a nondiscriminatory basis in line with multilateral principles prevailing in the world economy. In this context, the Government recognizes the need for continued close economic relations with the former republics of the U.S.S.R.. However, these relations will, of course, be less intense than during the

period when Estonia was part of the ruble area, and are expected to become less close as the restructuring process proceeds.

44. It is the intention of the Government to take all possible measures to avoid actions that would disrupt trade with former republics of the U.S.S.R.. It is committed to removing inter-state trade barriers, promoting direct trading between enterprises, and reducing direct Government involvement in trade relations. To that end, the Government will review and propose improvements in mechanisms for settling payments with the ruble area by September 30, 1992. Improvement in these trade and payments relations, will, however, require equivalent actions by other former Soviet republics. We note that part of the Fund's mandate is to assist member countries so that they do not resort to measures destructive of international prosperity. We understand that the Fund will work closely with the former Soviet republics and assist them in efforts to enter into cooperative agreements and relationships among themselves.

Systemic changes

45. Structural and systemic reforms are essential complements to macroeconomic stabilization. Consequently, specific systemic measures will be needed to accomplish our objectives. We have initiated, and expect to continue, discussions with the World Bank and other external lenders on areas of structural and sectoral reform. The World Bank staff will share with the Fund staff its assessment of progress being made in defining and implementing these programs to assist the Fund staff in evaluating progress under the Government's economic program described in this memorandum.

46. The Government believes that rapid privatization of the remainder of the state enterprise sector is a vital precondition for the return of growth of output and employment in Estonia. Accordingly, the Government will shortly present to Parliament legislation to establish a Privatization Bureau modeled on the German "Treuhand" that will be responsible for accelerating and coordinating the privatization process. At the same time, the Government also will seek Parliamentary approval (i) for the authorization of the sale of 260 larger pre-identified enterprises and to permit foreigners to participate fully in the privatization process (including the acquisition of land associated with the purchase of enterprises) and (ii) to establish a deadline of December 31, 1992 by which date all restitution claims on property will be recognized by the authorities; thereafter, valid claims will be honored only with restitution vouchers. The Government will also present legislation to Parliament by October 31, 1992 that will provide for the privatization of all medium and large state enterprises, except for a limited list that would remain under state ownership (mainly utilities and other strategic enterprises). 1/ Furthermore, to clarify the issue of ownership of property, the Government will by January 31, 1993 identify all nonrestitution property that can be made available for privatization immediately. To facilitate the assessment of the viability of enterprises, a new accounting law establishing EC-based accounting standards will be adopted by December 31, 1992. The Government will cooperate closely with the World Bank and the Fund staff in the preparation of these measures to ensure that they are consistent with the overall objectives of the stabilization and reform program.

47. The Government intends to give special attention to strengthening competition in the economy, both in production and distribution, especially as the full liberalization of prices may result in excessive profits by monopolistic enterprises. This will involve a combination of measures including: the removal of barriers to entry, such as the lack of developed real estate markets; the establishment of a regulatory framework which will eschew restrictive licensing requirements for production and distribution, a rapid identification and control of abuses of monopoly power. Basic competition and anti-monopoly legislation will be presented to Parliament by October 1, 1992 and concrete plans for the break up of the ten largest state-owned monopolies (excluding enterprises that are to remain entirely in state hands) and their restructuring will be formulated by November 30, 1992. The Government will also review the operations of industrial associations and concerns with a view to limiting their role in price fixing and maintaining barriers to entry by November 30, 1992.

48. Whereas privatization will enforce enterprise efficiency and profitability in the longer term, the success of the reform and stabilization effort in the transitional period will depend on the Government,'s ability to impose financial discipline on enterprises. For this purpose, a number of steps will be taken to ensure that enterprises face a hardened budget constraint during the transition. These include:

(i) budgetary support to enterprises will not be provided;

(ii) government guarantees on domestically financed loans to enterprises will be extended in only exceptional cases;

(iii) banks will be encouraged through the introduction of proper prudential banking supervision standards to evaluate their portfolios and to force borrowers to adhere to strict financial conditions, and the ability of enterprises to meet interest and principal payments on time will be essential for such loans to be renewed or extended; and

(iv) inter-enterprise credits and arrears will be monitored by the Bank in support of the broader restructuring effort described in paragraph 35 above.

49. The Government recognizes that there are weaknesses in the present institutional framework for monitoring economic developments and evaluating and coordinating policy. To effect rapid improvement, an inter-ministerial commission, which would also includes participation by the Bank, was established in June 1992, reporting to the Prime Minister, that is responsible for monitoring and reporting on the implementation of this program. We also intend to implement mechanisms for data collection and compilation so that national account, price, monetary, fiscal, and balance of payments statistics become available on a timely basis as from August 31, 1992. To assist in policy formulation, a unit will be formed at the Ministry of Finance responsible for maintaining a current data base on revenues and expenditures and making regular budget forecasts. Finally, a Research Department will be established at the Bank by September 30, 1992 that will be responsible for evaluating macroeconomic data and liaising with the Ministry of Finance to reconcile monetary and fiscal data.

1/ The list of enterprises the Government intends to retain under state or local authority control are listed in Appendix IV.

Balance of payments prospects and financing from the Fund

50. Over the medium term, we expect exports to strengthen substantially in response to the structural changes in production and the strong external competitive position that the Government intends to maintain. In the short run, however, the external position will deteriorate owing to the initial adverse impact of structural adjustment and the worsening in the terms of trade. The current account deficit is projected at some US$200 million for the program year 1992/93. In addition to private capital flows (mainly through direct investment), this deficit is expected to be financed by official balance of payments support, including from the Fund, World Bank, EBRD and bilateral donors. All purchases from the Fund are expected to permit a build-up of gross international reserves, to US$139 million by the end of 1992, including the reserves of the currency board.

51. We have established targets for the development in net international reserves--net of the official cover for Estonia's currency issue--as defined in Appendix V. Net international reserves defined in this manner amounted to the equivalent of minus US$6 million, on June 20, 1992. On July 8, the Swedish Government returned funds in lieu of gold held by Estonia in 1940, and on July 23, the Bank for International Settlements released the gold held in account with the Bank of England. Net international reserves, net of currency board cover, are expected to be at least US$12 million on December 31, 1992. In the event that additional gold held by the Bank for International Settlements on account in New York is returned to Estonia, this minimum target will be adjusted upward by the amount received.

52. All inflows of foreign grants and government borrowing will be centralized through the accounts of the Ministry of Finance, and a system will be established by August 31, 1992 to monitor, record, and project the flows of foreign assistance passing through the budget. The Government will not contract or guarantee loans of less than one-year maturities, with the exception of normal import financing, and will limit disbursements of contracted or guaranteed loans by the Government or the Bank of Estonia of maturities between one and five years to no more than US$SO million and between one and twelve years to no more than US$130 million during the period July l-December 31, 1992 (on a net disbursement basis). There will also be no accumulation of external arrears by the Government. Details are set out in Appendix VI.

Review of the program

53. The Government stands ready to take any further measures that may become necessary to achieve the overall aims of the program and will provide the Fund with such information as it may request concerning the implementation of the program. It will remain in close consultation with the Fund in accordance with Fund policies. In addition, we will complete with the Fund three reviews of economic developments and policies, the first by November 15, 1992, the second by February 15, 1993 and the third by May 15, 1993. These reviews will focus, inter alia, on the implementation of structural policies, in particular:

- at the first review, of the liberalization of prices as set out in paragraph 21, completion of the separation of the balance sheet of the currency board ("Issue Department") from the Banking Department of the Bank of Estonia as set out in paragraph 32, improving the operation of the clearing system as set out in paragraph 33, and the presentation to Parliament of the competition law as set out in paragraph 47;

- at the second review, of the review of groups eligible for state assistance and rationalization of the pension system as set out in paragraph 29, the development of plans for restructuring the banking system as set out in paragraph 35, and the presentation to Parliament of the comprehensive privatization law as set out in paragraph 46;

- at the third review, of the approval and publication of enforcement procedures for banking supervision as set out in paragraph 33, and the identification of non-restitution property as set out in paragraph 46.

The quantitative performance criteria for the first half of 1993 will be specified at the time of the second review.

APPENDIX I

Net Claims on the General Government

	In millions of kroons 1/
Preliminary data for end-June, 1992	-150
Limits on:	
end-September, 1992	-105
end-December, 1992	-150

1/ Any subsequent upward (downward) revisions to the base value in kroons for June 30, 1992 will imply equivalent upward (downward) adjustments in kroons to the targets of net claims for September 30, 1992 and December 31, 1992.

The financial transactions of the general government with the banking system are those of the central government (comprising the state budget and budgets of extrabudgetary funds) and of the local governments. The central government extrabudgetary funds include, but are not limited to the Social Security, Medical Insurance, Environment, Agriculture, Forestry, Information, Innovation, and Scientific Research funds.

Net claims of the banking system on the general government are defined as all claims of the banking system on the general government less all deposits of the general government with the banking system. These deposits should exclude counterpart funds generated by foreign loans intended for balance of payments support (including but not limited to World Bank loans, and loans from the EC and the G-24), 2/ counterpart funds generated from grants and not fully under the control of government, and government lending funds (which are channeled through the banking system for development purposes and therefore not usable to finance government deficits).

The claims of the banking system on the general government include (a) banks' loans to the general government, (b) securities or bills issued by the general government held by banks, and (c) overdrafts on the current accounts of the general government with banks.

The deposits of the general government with the banking system include but are not limited to: (a) the net of the expenditure and revenue accounts of the general government with banks; (b) other deposits of the general government with banks excluding counterpart funds and government lending funds mentioned above; and (c) securities issued by banks held by the general government.

The quarterly limits will be cumulative and will be monitored monthly from the accounts of the banking system; the Ministry of Finance shall confirm these data. Data on net claims on government, in the agreed format, will be reported to the Fund within thirty days of the end of each month by the Bank of Estonia.

2/ All such funds should be placed in blocked accounts with commercial banks.

APPENDIX II

Reserves of the Banking System

For the purposes of calculating excess reserves of the banking system in the context of program monitoring, required reserves will be calculated as equal to 10 percent of the banking system's kroon deposit liabilities (excluding the Savings Bank) as presented in the monetary survey. These deposit aggregates against which required reserves will be calculated will be referred to as "eligible liabilities". Required reserves for September 30 will be calculated in this manner from the monetary survey of August 31, and for December 31 will be calculated from the November 30 monetary survey.

"Actual reserves" of the banking system (not including the Savings Bank) will be calculated as the sum of deposits in the banks' "required reserve" accounts with the Bank of Estonia plus the deposits of "correspondent" accounts of banks (not including the Savings Bank) with the Bank of Estonia. Actual reserves of the banking system will not be permitted to be below required reserves of the banking system, as defined in the above paragraph, by more than 1 percent of eligible liabilities, as defined above, for end September and end December 1992. Compliance with these performance criteria will be calculated from the monetary survey of August 31, 1992 and the Bank of Estonia's balance sheet for end September, 1992 and from the monetary survey of November 30, 1992 and the Bank of Estonia's balance sheet for end December 1992, respectively.

Henceforth, the Bank of Estonia will not extend any new credits to commercial banks, except in emergency situations and in amounts that do not violate (i) the performance criterion requiring full foreign currency backing for the currency board liabilities or (ii) the performance criterion specifying the minimum targets for net international reserves, exclusive of currency board cover. Lending in emergency situations, subject to the above limits, would be effected by the transfer of available excess foreign exchange reserves from the Banking Department to the Issue Department of the Bank of Estonia, in an amount equivalent to the kroon total deemed necessary for lending to the banks. The Issue Department would thereby make such kroons available to the Banking Department. Such lending would then appear only on the balance sheet of the Banking Department.

APPENDIX III

Incomes Policy Measures

The incomes policy measures stipulated in paragraphs 36-38 of the Memorandum of Policy are defined as follows for the period August-December, 1992:

1. The guideline for the increase in the average employee compensation in the government sector and state enterprises and in the minimum wage will be based on the new consumer price index. Actual

developments in this index for January-July, 1992 and targets for August-December, 1992 are shown below.

Consumer Price Index 1/

1992	(Index Jan 1992 = 100)	(Percentage change from previous month)
January	100.0	87.5
February	173.9	73.9
March	226.0	30.0
April	250.0	10.8
May	263.0	5.2
June	292.9	11.4
July	364.1	24.3
August	382.2	5.0
September	407.8	6.7
October	430.7	5.6
November	454.8	5.6
December	461.6	1.5

1/ To be replaced by the new consumer price index.

2. In July 1992, wage compensation was frozen at May 1992 levels, allowing adjustment for June price increases. The target increase in the consumer price index for the period August-December 1992 will be announced following the publication of the July 1992 consumer price index on August 7, 1992. The guideline for the increase in the average compensation per employee during August-December, 1992 would be set at the same rate as targeted inflation. The Government's target is to slow down the rate of monthly inflation to below 2 percent by the end of the year. Wage increases would allow full compensation for the rate of targeted inflation, thus maintaining real wages and avoiding a wage-price spiral. Average compensation in the government sector would be subject to this guideline. As regards individual state enterprises, any increase in average compensation in excess of the guideline will be penalized by a punitive tax to be levied on enterprises, as described in paragraph 38. Allowing at least partially for special factors, such as increases in bread, gas, and heating prices, the guideline for the increase in average compensation during the period August-December, 1992 would be 26 l/2 percent. During the first incomes policy period, the average wage will be raised twice, on September 15 and on November 15; on September 15, by 12 percent and on November 15, by 13 percent. The incomes policy would be continued in 1993 with wage adjustments to be made on a quarterly basis. The Government will review the incomes policy guidelines for the first time in November, in connection with the first program review with the Fund. When the price index for October 1992 is announced and if the actual price increase during August-October 1992 were to differ from the initially agreed increase by more than 5 percentage points, the guidelines for average wage compensation for the November-January 1993 period will be reviewed to take any such shortfall or excess into account. Analogous reviews would be made in respect of subsequent incomes policy periods.

3. For the purpose of calculating the minimum wage increase on September 15, 1992, the basis for the percentage increase will be the minimum wage in July 1992. In the example in paragraph 2 above,

the acceptable increases in the average wage on September 15 and November 15 are 12 percent and 13 percent, respectively. Thus, the average minimum wage for September and for November 15 should not exceed EEK 224 and EEK 253, respectively.

4. As stipulated in paragraph 36 the private sector will be exempt from the incomes policy measures. It is thus important to determine which enterprises should be characterized as (nonbudgetary) public enterprises and, conversely, which enterprises should be considered private for the purpose of applying these stipulations. According to international definitions (SNA), an enterprise is considered a public enterprise if the public authorities "own all, or a majority of the shares, or of other forms of capital participation, or in equity of the unit". Another criterion used is that an enterprise is considered a public enterprise if the public authorities control the enterprise, whether or not they have majority ownership in the enterprise. However, because of the many forms in which public authorities may exercise control over enterprises, it is difficult to indicate who effectively controls an enterprise, particularly in a country like Estonia where public ownership of enterprises is widespread. Therefore, it is suggested to use only majority ownership as the criterion to decide whether or not an enterprise is a public or private entity for the purpose of the stipulations in paragraph 36.

5. "Average employee compensation" is defined as gross incomes per employee. Gross incomes cover salaries, premiums, cash and in kind support, interest subsidies, distributed profits, incomes from company shares, etc., as defined in paragraph 37 in the Statistical Central Office's publication "Instructions for Labor Force and Salary Reporting".

APPENDIX IV

Enterprises to Remain Under State Control

The following is a list of eleven enterprises with a net worth in excess of EEK 10 million that the Government intends to retain under state or local authority control for the indefinite future. 1/ This list excludes establishments that are engaged in what are normally regarded as non-commercial activities (e.g., museums, higher and secondary specialized educational institutions, research institutes, hospitals and government

	Enterprise	Main Area of Activity
1.	Eesti Kutus	Fuel Importation and Sales
2.	Eesti Energia	Electricity Generation and Sales
3.	Eesti Polevkivi	Oil shale mining
4.	Eesti Gaas	Importation and Sales of Natural Gas
5.	Kunda Tsement	Cement manufacturing
6.	Eesti Telekommunikatsioond	Telecommunications
7.	Polevkivikeemia	Oil shale-based chemicals
8.	Eesti Raudtee	Railways
9.	Tallinna Sadam	Water services support
10.	Tallinna Paber	Pulp and paper manufacturing
11.	Kehra Paber	Pulp and paper manufacturing

The Government also intends to retain control of about 17 other industrial establishments, each with a net worth of under EEK 10 million, and also selected theaters, concert halls and other predominantly cultural and non-commercial establishments.

1/ "Control" is implied if the public authorities own all, or a majority of the shares, or other forms of capital participation, or in the equity of the enterprise.

APPENDIX V

Net International Reserves in Convertible Currencies

Net International Reserves (exclusive of currency board cover)	Minimum limits (in millions of US dollars)
Actual stock at June 20, 1992	-5.5
September 30, 1992	12.0
December 31, 1992	12.0

Net international reserves consist of gross reserves of the Bank of Estonia, net of reserve liabilities and net of currency board cover (including provision for the liabilities of the Savings Bank). Gold claimed by Estonia and held by the Bank for International Settlements in New York is presently subject to litigation. In the event that these funds are released to the Bank of Estonia prior to the test dates, the above targets will be adjusted upwards by the amount of the funds involved.

For the purposes of the program, gross reserves of the Bank of Estonia shall be defined as monetary gold, holdings of SDRs, any reserve position in the IMF, and holdings of foreign exchange in convertible currencies by the Bank of Estonia. Excluded from reserve assets are capital subscriptions to foreign financial institutions, long term nonfinancial assets of the Bank of Estonia, assets held abroad by the general government and enterprises, and any assets in nonconvertible currencies. For the period of the program, the exchange rates for all foreign currencies will be frozen at their June 20, 1992 levels. In particular, the US dollar/deutschemark rate will be fixed at DM1.57 per US dollar. Monetary gold will be valued at deutschemark 535 per ounce. Fund staff will be informed of details of any gold sales, purchases or swap operations during the program period, so that adjustments can be made to exclude changes in the value of gross reserves that arise merely from a different valuation of gold. On June 20, 1992, gross reserves of the Bank of Estonia, as defined above, amounted to US$54.5 million, including gold holdings valued at US$52.7 million.

For the purposes of the program, reserve liabilities shall be defined as the Bank of Estonia's convertible currency liabilities to nonresidents, with an original maturity of up to and including one year and the use of Fund credit. Excluded from reserve liabilities are any liabilities arising from balance of payments support loans of maturity longer than one year, including such loans from the EC, the BIS and other international financial institutions, foreign governments and foreign banks. On June 20, 1992, international reserve liabilities of the Bank of Estonia, as defined above, amounted to $0.

The cumulative targets will be monitored from information supplied weekly by the Bank of Estonia in the agreed format. The weekly data will be provided to the Fund within seven days of the end of each week throughout the program period. Currency board liabilities will comprise kroon notes and coins in circulation, kroon reserve deposits of banks, including "required reserves" and "correspondent" accounts, .and the liabilities of the Savings Bank. When the balance sheet of the Savings Bank is formally prepared, with reserve deposits explicitly held with the Bank of Estonia, as explained in paragraph 32 of the Memorandum, the liabilities of the currency board will be taken to include these reserve deposits, in place of the deposit liabilities of the Savings Bank. Currency board cover will equal currency board liabilities, expressed in terms of foreign exchange using the official exchange rate of 8 kroons per CM and the agreed exchange rate of DM1.57 per US dollar. On June

20, 1992, currency board liabilities amounted to the equivalent of US$60.0 million.

APPENDIX VI

Limits for External Debt of the Estonian Government and the Bank of Estonia
(includes debts directly contracted or guaranteed)

Cumulative net disbursements of external debt	Maximum limits (in millions of US dollars)	
	1-12 year maturity	1-5 year maturity
During the period from June 30, 1992 to:		
December 31, 1992	130	80

l/ Maturities of greater than one year through 12 years.
2/ Maturities of greater than one year through 5 years.

External debt limits apply to net disbursements (disbursements less repayments) of medium- and long-term external debt of original maturities of more than 1 year up to and including 5 years and of more than 1 year up to and including 12 years. The government is defined as comprising the state and local authorities, and all extrabudgetary funds. Excluded from the limits are use of Fund resources; but other balance of payments support of maturity longer than one year is covered by these limits, including loans from official creditors and foreign banks. Disbursements and repayments shall be valued in the currencies of transactions and converted into US dollars each month at the average exchange rate for the month.

Compliance with the limits shall be verified for the date shown above. Information on net disbursements of external debt, in the agreed format, will be reported monthly to the Fund within thirty days of the end of each month by the Ministry of Finance.