APPENDIX III
Tallinn, June 18, 1996

Dear Mr. Camdessus:

1. The attached Memorandum of Economic Policies describes the economic program the Estonian Government intends to pursue in the period April 1, 1996 to June 30, 1997. The objectives of these policies are to strengthen the economic recovery of the past year, further reduce inflation, and maintain a sustainable external payments situation. To achieve these objectives, we are committed to the continued pursuit of tight financial and budgetary policies in the context of the currency board arrangement, an open trade system, and structural market reforms that encourage private sector activities, as detailed in the Memorandum.

2. In support of this economic program, we hereby request a thirteen-month stand-by arrangement in an amount equivalent to SDR 13.95 million (30 percent of quota). While we currently do not intend to make purchases under this stand-by arrangement, we would do so should circumstances warrant.

3. Before consideration of our request by the IMF Executive Board, we will implement the revenue measures related to VAT exemptions envisaged in paragraph 16 of the Memorandum, or agree with the Fund staff on equivalent measures having the same effect.

4. We believe that the policies described in the attached Memorandum are adequate to achieve the objectives of the economic program, but are prepared to take additional measures that may be appropriate for this purpose. During the period of the arrangement, we will consult with the Fund on the adoption of any such measures that may be appropriate in accordance with the Fund's policies on such consultations. During the program period, a review with the Fund will be carried out no later than March 15, 1997. Performance criteria for March 31, 1997 and June 30, 1997 will be established at the time of the review.

Yours sincerely,

/s/	/s/
Tiit Vahi Prime Minister	Vahur Kraft Governor, Bank of Estonia

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

APPENDIX IV

Memorandum of Economic Policies of the Estonian Authorities for 1996-97

I. Introduction

1. The Estonian economy continued to make significant gains in 1995. The recovery in economic activity gathered momentum as real GDP, led mainly by exports of manufactures and services, grew by some 3 percent. Higher output and an increasingly dynamic private sector contributed to the containment of measured unemployment to 5 percent of the labor force. Judging by the rise in real wages, living standards of the population further improved. Inflation averaged 29 percent, broadly as projected under the economic program for the year, and down considerably from the 48 percent

registered in 1994. The favorable performance of exports helped contain the external current account deficit to 5.3 percent of GDP despite continued strong growth in imports, with the deficit being largely covered by foreign direct investment.

2. The key to these favorable economic results was the pursuit of sound macroeconomic policies formulated within the context of Estonia's currency board arrangement, and further implementation of structural policies aimed at transforming the Estonian economy into a vibrant market place. These policies earned the continued support of the international financial community, including a stand-by arrangement from the International Monetary Fund (IMF).

3. Estonia met all the quantitative performance criteria set under the IMF program except for the end-December 1995 and end-March 1996 criterion on the financial deficit of the general government. In addition, the authorities implemented many of their commitments in the area of structural reforms. Admittedly, there were some delays, as in the case of land privatization, social security reform, and in finding solutions to banking problems. While some of the delays could perhaps have been avoided, others resulted from the need to maintain an open political decision-making process rather than from any lack of commitment to market reforms.

4. The domestic operations of the general government for 1995 were broadly in balance. Including foreign-financed capital expenditures and net lending, there was an overall deficit of 0.8 percent of GDP (lower than the program target) compared to a surplus of 1.3 percent of GDP in 1994. The Bank of Estonia adhered to its commitments under the currency board, and monetary aggregates were closely in line with program projections. In part as a result of a larger than anticipated build-up of the capital base of banks (including with foreign participation), overall credit expansion was somewhat higher than projected. The combination of the fiscal deficit and the faster than expected growth in credit may have contributed to pressures on prices.

5. The scope of structural reforms broadened in 1995, particularly in the privatization of medium- and large-scale enterprises as well as housing, and in the development of a sound financial system equipped to address the needs of an emerging market economy. The regulatory environment for domestic financial institutions, notably bank supervision and prudential regulations, was further improved as the capital base of banks was strengthened. Despite often strong lobbying, the Government maintained a highly open trade regime. Progress was also made in enhancing the efficiency of the budgetary and tax systems, mainly with the creation of a national Treasury.

6. Notwithstanding the above accomplishments, the economic recovery and progress toward price stability are likely to remain fragile for some time. Progress has been unequal across sectors and regions. Inflation is still high, even allowing for adjustments in relative prices, which themselves are still far from complete. Rising costs are challenging enterprises to remain competitive by increasing productivity, including through labor shedding.

7. The public finances have emerged as a potential source of instability and need to become a central focus of Government policy. Pressures to increase social and capital expenditures and to allow a rapid increase in borrowing, especially by local governments, have not been sufficiently resisted. This could generate a fiscal outcome that is incompatible with a further reduction in inflation, particularly as inflows of foreign capital to the nongovernment sector will likely remain buoyant. Further consolidation and improvement in the soundness of the banking system is also needed to secure macroeconomic stabilization as well as financial deepening. The problems associated with residual state ownership and especially land privatization could, if left unanswered, stifle competition and hinder economic performance.

8. To address these challenges, the Estonian authorities have formulated an economic program covering the period April 1, 1996 through June 30, 1997, which is described below and for which support from the IMF under a new stand-by arrangement. is being sought. While Estonia has no foreseeable balance of payments need and has no plans to use the financial resources made available under the arrangement, the Government views this support as important to mobilize a solid consensus for its reforms and to enhance their credibility.

II. Objectives for 1996-97

9. The broad macroeconomic objectives of the Estonian authorities' economic program for 1996-97 and into the medium-term are to (i) strengthen the recovery in economic activity; (ii) further reduce inflation to protect Estonia's competitiveness, bearing in mind that the pace at which this can be accomplished will be limited by the need to continue with relative price adjustments; and (iii) contain the external current account deficit to a level that can continue to be financed largely by direct foreign investment. Achievement of these objectives will necessitate (i) a renewed commitment to the pursuit of tight financial policies; (ii) maintenance of strong incentives for export-led growth; (iii) acceleration of efforts to reduce the role of government in the economy in order to free resources and provide greater incentives for private sector activities; (iv) maintenance of a highly competitive environment and flexible market conditions for price and wage determination; and (v) further progress in privatization, with development of capital, land, and real estate markets as a condition for deepening economic restructuring and improving enterprise governance as well as fostering private savings.

10. The authorities believe that the present currency board arrangement remains an appropriate institutional framework for meeting the above requirements. Efforts to further reduce price and wage inflation and improve productivity should ensure the maintenance of Estonia's competitiveness on the international markets at the current peg for the Estonian Kroon.

11. Specifically, the economic program aims at achieving annual real GDP growth rates of 3-4 percent in 1996-97; reducing average inflation to just above 25 percent and 20 percent in 1996 and 1997, respectively; and containing the external current account deficit to around 7 percent of GDP in 1996 and 6 percent of GDP in 1997. Continued stabilization and structural reforms beyond 1996-97 would be expected to consolidate economic growth at more than 5 percent a year and to achieve a decline in annual inflation to about 10 percent by the end of the century.

III. Policies

Fiscal policy

12. Under the currency board arrangement, fiscal policy assumes a special responsibility in containing domestic demand pressures and therefore inflation. In view of buoyant demand in the private sector and inflows of capital to that sector, further reducing inflation while promoting growth will continue to require a prudent fiscal policy; this would also help limit the external current account deficit. Foreign financing must be used mainly for projects with high rates of economic and social return. The Government thus intends to contain the overall deficit of the general government to EEK 720 million (1.4 percent of GDP) in 1996 and to EEK 320 million (0.5 percent of GDP) in 1997. This will cover all the consolidated operations of the central and local governments and extrabudgetary funds, including all public policy-related capital and net lending operations, whether domestic or foreign-financed. The Government's commitment to this concept of fiscal operations will be fully reflected in the presentation of the 1997 Budget.

13. A number of recent fiscal developments, if unattended, could jeopardize the achievement of the above fiscal objectives in the short- and medium-run. Foremost among these is the increased borrowing, including external borrowing, by local governments on their own to finance expenditures, often on terms that raise doubts about their ability to meet debt service obligations. To limit this threat, the Government will issue before July 1, 1996 a decree which clarifies that the Government will extend neither explicit nor implicit state guarantees against such borrowing. The Government will also introduce in Parliament by September 15, 1996 legislation (amending the 1993 Law on Municipalities and Towns, and the 1995 Law on Taking Foreign Loans and Giving State Guarantees to Foreign Loan Agreements) which will (i) make more stringent the existing limits on borrowing by local governments; (ii) require the municipalities to make their borrowing plans part of their annual budget and subject such borrowing to Parliament's approval; (iii) require the local authorities to notify the Ministry of Finance within 30 days of any new contracting of debt and its terms; and (iv) specify that in the case of default by local governments on their debt obligations (with or without state guarantee), including on government net lending, the central government would have the right to take over their financial operations.

14. Another focus of government policy is the urgent need to strengthen the operations of the National Tax Board and Customs Administration, especially as regards developing a comprehensive program of tax audits and improving internal controls to curtail tax evasion. Weaknesses in these areas have

contributed to the observed decline in the revenue/GDP ratio. Steps are being taken to address the situation, including adoption of IMF technical assistance recommendations. These steps will emphasize (i) development of a National Audit Plan and strengthening of audit procedures complementary to the introduction of a taxpayers identification system; (ii) introduction no later than October 1, 1996 of legislation requiring proper bookkeeping practices by enterprises for VAT purposes, including maintenance of sale and purchase ledgers; and (iii) strengthening of the use of customs tax information by the National Tax Board for the purpose of collecting VAT and excises on imports. The Government also aims at transferring all responsibilities for the administration of the Social Tax (collection and auditing) to the National Tax Board.

15. A third matter of concern relates to the operations of the Social Insurance Fund, which would result in a substantial deficit for 1996 (equivalent to about 0.8 percent of GDP) if the Fund were to fully implement its budget plans to raise pensions in the course of the year. In order to limit the deficit of the Fund, the Government does not intend to increase pensions beyond the adjustment made in April 1996; this should generate at least EEK 90 million in savings.

16. In addition to the above actions, achievement of the overall fiscal deficit target of 1.4 percent of GDP in 1996 necessitates discretionary measures amounting to about EEK 1.2 billion (2.3 percent of GDP) to preempt a more expansionary stance of fiscal policy. Specifically:

- tax revenue will be strengthened by eliminating the VAT exemptions for (i) construction materials and (ii) light heating oil. Legislation to this effect will be submitted to Parliament shortly, with a view to making the measures effective by August 1, 1996. These measures are expected to yield EEK 200 million and EEK 55 million, respectively, over the remainder of the year. To further strengthen the state budget, the Government is also considering the introduction of an annual car tax. In any case, the Government will agree with the Fund on any alternative measures necessary to offset the revenue loss--and the timing for their implementation--should it become apparent that Parliament will not approve the above measures within the envisaged timetable.

- implementation of certain capital expenditures of the central and local governments as well as of non-wage current expenditures of the central government (which increased substantially in real terms in 1995 and were projected to increase further in 1996) will be delayed, with a net impact equivalent to about EEK 900 million of savings in 1996 (current expenditure savings amounting to EEK 100 million). Any carry-over for next year will be fully taken into account in the formulation of the 1997 Budget. In the event that the revenue performance later in the year turns out to be better than projected, some of the above postponed expenditures will be reinstated.

Furthermore, the general government wage bill will remain within the limits implied by the 1996 Budget, except for a small adjustment related to wages for teachers and cultural workers amounting to EEK 50 million.

17. In line with the Government's intention to take a more global view of fiscal operations and to integrate more fully activities of local governments within fiscal policy choices, we aim at greater aynchronization between the budget preparations of central and local governments starting with the formulation of the 1997 Budget. Hence, negotiations between the Ministry of Finance and local governments on expenditure targets and sources of financing will be undertaken in parallel with those between the Ministry of Finance and other Ministries and units of the general government. Achievement of the objective to reduce the deficit of the general government to 0.5 percent of GDP in 1997 will be made possible by (i) the full year impact of the revenue measures cited above; (ii) the generation of public savings at the level of the state budget, including by improving tax administration and containing the growth of wage and administrative expenditures to just above 10 percent; (iii) the commitment to a balanced budget for the Social Insurance Fund; and (iv) the containment of public investment to around EEK 2.6 billion (4 percent of GDP).

18. The Government believes that rapid and sustainable growth will require a reduction in the still excessively large role of government in the economy. This calls for structural reform of the public expenditure system toward improving the efficiency of the provision of public goods and services, and greater involvement of the private sector in their provision. This should permit the Government, at the same time, to reduce its overall outlays. The authorities will collaborate with the World Bank and the IMF in formulating the necessary public expenditure reforms. To begin with, the Government will seek

before end-1996 World Bank assistance in conducting a comprehensive public expenditure review. Only lower spending will allow an eventual reduction in the tax burden. In the meantime, the Government does not intend to undertake any major revision to the tax system during the program period, with the exception of the social tax (see paragraph 20 below). If Parliament, contrary to the Government's recommendation, were to approve any fiscal changes that could threaten the achievement of the overall deficit target, including eliminating or reducing the corporate income tax, the Government would implement offsetting revenue or expenditure saving measures.

19. A reform of government employment and pay policy will be initiated with the 1997 Budget. The longer-term objective will be to reduce staffing in the public sector. Part of the savings generated could be used to improve compensation in sectors where it has proved difficult to retain qualified personnel, as in tax administration and statistics.

20. Regarding the social safety net, new Pension and Social Tax laws aimed at establishing a more direct link between contributions and benefits and a sharing of contributions between employers and employees will be submitted to Parliament no later than November 1, 1996.

21. The Government does not intend to create any new budgetary funds, nor broaden the scope of existing ones- -for instance by adding credit guarantees for agriculture and exports. The amounts provided under these funds in 1996 and 1997 will not exceed EEK 214 million and EEK 250 million, respectively. The objective remains to involve the banks as much as possible in the allocation of these funds rather than have Government direct.credit to specific enterprises.

22. The Government will formulate for the beginning of 1997 specific proposals to streamline local government operations, including incentives to consolidate some of the 254 such governments now in existence. The process would be expected to result in substantial personnel and other expenditure savings. The formulas for the allocation of fiscal revenue and inter- governmental transfers will be reviewed with that objective in mind.

23. At the beginning of 1996, the Government finished putting in place all central and regional Treasury structures and selecting four banks where Treasury accounts would be established. Treasury operations began April 1, 1996 for the central government, and negotiations are currently on-going to include the Social and Medical Insurance Funds at the beginning of 1997. The Ministry of Finance is cooperating-- informally and in the framework of the Banking Relations Board--with the Bank of Estonia as well as with the commercial banks to ensure that operations of the Treasury and other budgetary institutions will not create abrupt shifts in liquidity within the banking system.

Money and banking policies

24. There has recently been a decline in the cash/deposit ratio, which albeit fairly modest, is indicative of some financial deepening taking place; there has been a similar trend in velocity. Under the present institutional arrangement, continued financial deepening will critically depend on increasing confidence in the domestic banking system in addition to reducing inflation. The resulting increase in the money multiplier should then lessen the need to run overall balance of payments surpluses to meet the liquidity requirements of a growing economy.

25. The Bank of Estonia implemented a number of changes in the system of reserve requirements for banks as of July 1, 1996, including monthly averaging, with a view to facilitating commercial banks' liquidity management. Overall, these changes will marginally increase the ratio of banks' eligible domestic deposit liabilities that are covered by eligible reserve assets with the central bank, and therefore slightly decrease the money multiplier. In view of buoyant foreign inflows to commercial banks, the Bank of Estonia has decided to proceed cautiously in considering any reduction in reserve requirements, and intends to maintain the required rate at 10 percent during the program period. It is considering remunerating reserves of banks with the Bank of Estonia and will be introducing fees for its payments operations.

26. While capital inflows so far have mainly been in the form of foreign direct investment, there has been in recent months a greater flow of resources into Estonian banks from foreign financial institutions. These inflows will need to be closely monitored, and the Bank of Estonia will be ready to consider steps to limit their impact on the ability of banks to expand credit should these inflows

threaten the objective of reducing inflation or encourage imprudent lending. We will, however, consult with Fund staff before implementing any such steps.

27. In line with its earlier commitment, the Bank of Estonia will continue to limit its role as lender of last resort to emergency situations where bank illiquidity poses a systemic risk. Contingency lending for this purpose will be no more than EEK 100 million (0.2 percent of GDP) for the duration of the program, unless the Government accepts the financial burden of additional support.

28. The pace of banking sector restructuring has accelerated in recent months with the increase in the minimum capital requirement to EEK 50 million and the reduction in the number of commercial banks from 20 to 15, partly through bank mergers. The capital requirement will be further raised to EEK 60 million effective January 1, 1997. The Bank of Estonia will closely monitor the performance of remaining banks during coming months. At the time of the completion in April 1996 of annual bank audits meeting international standards, all banks were in compliance with the minimum capital requirement and other prudential regulations. Additional bank restructuring, including through mergers, is expected before a planned deposit insurance scheme (see paragraph 31) becomes effective.

29. A rescue package for the North Estonian Bank (NEB) was agreed by the three shareholders (the Government, the Bank of Estonia, and the privately owned Union Bank) last December, including a shareholders' guarantee for part of the bank's portfolio. The financial position of the NEB is showing some modest improvement with the implementation of a business plan formulated as part of the rescue package, with the bank generating profits so far this year. The just completed international audit of the NEB indicates that the bank met all prudential requirements, after taking the guarantee into account. It is recognized that in line with its commitment under the recent Fund program, the Bank of Estonia cannot be called upon to commit any resources from its balance sheet under the guarantee, as this would undermine the credibility of the currency board arrangement. Accordingly, the shareholders will review the modalities of the guarantee with a view to facilitating the operations of the bank and attracting new investors without injecting additional public resources.

30. The next audit of the NEB is scheduled for the December 31, 1996 balance sheet. In the event that the results of this audit suggest that the recovery plan for the NEB is not viable (i.e., that the NEB would be unlikely to meet all prudential requirements at the time the guarantee expires), other options would be considered.

31. A draft Law on a Deposit Insurance Scheme (DIS) is being finalized for submission to Parliament. The objective of the scheme is to help speed up the process of financial deepening without creating an excessive risk of moral hazard and endangering public finances. The latest draft incorporates many comments provided by the IMF and other international bodies. Insurance will not become effective within the program period. To strengthen the ability of the DIS early on to meet any possible financial claims, which are more likely over the next 2-3 years as bank restructuring is completed, the initial contribution fee proposed in the law,will be 0.5 percent of backed deposits (in line with practices in other Eastern European transition countries) and will be maintained through at least year 2000. The initial coverage ceiling will not exceed EEK 20,000.

32. The Bank of Estonia is taking further steps to strengthen and develop bank supervision by enacting additional elements of the legislative and regulatory framework. The Banking Supervision Department will continue to monitor carefully large exposures, connected lending, open foreign exchange positions, loan-loss provisioning, and off-balance sheet operations. Special attention will be directed at banks having substantial investments in high yielding foreign securities subject to large foreign exchange risks. Amendments to the Credit Institutions Act as necessary to strengthen the authority of the Bank of Estonia in these areas will be submitted to Parliament no later than November 1, 1996, to further strengthen and clarify the Bank of Estonia's banking supervision operations; they will include in particular a provision allowing exchange of information between the supervisory authorities and external auditors. The Bank of Estonia will further develop its early warning mechanism for the banking system utilizing the experience of other countries. In this context, the Bank of Estonia will improve its capabilities to analyze liquidity and money market developments.

Structural policies

33. Estonia presently has a highly open trading regime. This regime will not be modified in a more restrictive direction during the period covered by this arrangement. While Parliament approved in September 1995 a law on the Regulation of the Agricultural Produce Market allowing the imposition of import tariffs, the Government has no plan to call upon its provisions. Furthermore, threshold prices for agricultural imports will not be introduced. However, a system of reference prices for imports of agricultural products some 25 percent below international prices will be temporarily implemented. These reference prices will be used to help verify the accuracy of the declared import value, and will in any event be fully consistent with WTO norms. Following the strengthening of customs and quality control procedures, to be undertaken in consultation with the WTO, these reference prices will be eliminated no later than June 1, 1997. All import tariffs were removed last year, and equalization of all excises on domestic and imported goods was implemented as of January 1, 1996, with the exception of excises on beer, which will be equalized by December 1, 1996. The Government aims at completing Estonia's accession to the WTO by end- 1996. While Estonia has requested higher tariff bindings for imports than the current zero tariffs, the Government has no intention of introducing import duties at any time in the foreseeable future.

34. The scheduled privatization during 1996 of about a dozen remaining medium-to-large scale state enterprises not qualifying as natural monopolies will largely complete enterprise privatization in Estonia, with the main exception of five infrastructural monopolies. The most important infrastructural companies are the Estonian electricity complex (Eesti Energia) and the oil shale company (Eesti Polevkivi), and the Government intends to focus on privatizing these industries within the next two to three years. To that end, the Government is developing a program to corporatize and restructure these companies, starting with audits of their balance sheets to an international standard and their conversion into joint- stock companies. For Eesti Energia, restructuring will focus on forming separate generation, transmission, and distribution companies; and for Eesti Polevkivi, on dividing the mines into several competing companies. The Government's aim is to complete the restructuring of the balance sheets on the basis of an evaluation of assets and liabilities by end-December 1996. Thereafter, and once the Monopoly Regulatory Board has started to operate (see paragraph 36 below), the Government will begin to privatize these industries, starting with the electricity generation companies.

35. It is recognized that at EEK 0.39/kwh the price of electricity in Estonia is substantially below long-run generation costs. Rents and district heating tariffs also continue to be at levels that barely cover operating costs. Pending the establishment of the MRB and the privatization of Eesti Energia, the Government raised the electricity price to EEK 0.45/kwh, effective June 1, 1996, both to keep up with rising costs and prevent further decapitalization of the electricity industry (a corresponding increase will be made to oil shale prices). Adjustments to cover an increasing share of the long-run cost would be implemented by the MRB as of March 1997. The Government will make clear to both households and industrial users that electricity prices in Estonia will inevitably converge over the medium-term to European levels as the industry is restructured and privatized, and trading within the region increases.

36. The Government recognizes that the successful privatization of large infrastructure companies, which in most cases enjoy dominant market positions in their sectors, will require the elaboration of explicit commercial objectives. Accordingly, the Government is considering an amendment to the Price Law establishing a Monopoly Regulatory Board (MRB), which it intends to submit to Parliament no later than end-1996. The MRB will be solely responsible for regulating prices in key sectors where one or more enterprises are expected to maintain a dominant position for the foreseeable future, including the energy, telecommunications, and transport services sectors. The Board will include, inter alia, representatives from the Ministries of Finance, Economy, and Justice as well as from the Competition Board. The objectives of the MRB will include (i) regulation of prices for services with the objective of covering costs plus allowing a reasonable profit; (ii) ensuring freedom of entry for competitors, in particular by ensuring right of access to essential facilities; and (iii) the fulfillment of public service obligations, such as the provision of a secure, efficient, and stable supply of utility services on a non-discriminatory basis. The MRB will begin operating in March 1997.

37. In parallel with the establishment of the MRB, the Government will also strengthen the Competition Board as there is evidence that in certain sectors enterprises that. are not monopolies also try to abuse dominant positions and/or distort trade and commerce through restrictive agreements or barriers to entry. To deal with this threat, the Government will submit to Parliament by March 1, 1997 amendments to the Competition Law which, in particular (i) strengthen regulatory powers related to the

prevention of free entry or abuse of dominant positions, control over mergers, and restrictive agreements; (ii) enhance the ability of the Competition Board to obtain relevant information from enterprises; and (iii) improve the effectiveness of sanctions in the event that anticompetitive behavior is established. Assistance from EU Phare would be sought in implementing policies in paragraphs 34, 36 and 37.

38. Land reform has so far not kept pace with enterprise privatization. Substantial obstacles to the land reform process have been removed with the passage in April 1996 of amendments to the Land Reform Law. In particular, the provisions that (i) simplify survey procedures and (ii) allow municipalities to retain the land tax only from privatized or restituted land, are expected to facilitate land privatization and the restructuring of agriculture. In the case of sales of land to privatized enterprises, the Government regards existing procedures as unnecessarily complex and vulnerable to delaying tactics on the part of local governments. In December 1995, the Government gave the right to the Estonian Privatization Agency (EPA) to privatize the land associated with enterprise sales. To accelerate land sales, the Government will enact by August 1, 1996 a decree that requires municipalities (i) to inform the EPA at once that a private enterprise has formally requested the purchase of land within their territory; (ii) t o complete all necessary formalities within three months after a request is submitted; if this deadline cannot be met then the EPA will be consulted immediately to assist in expediting the land sale; and (iii) inform enterprises without delay in the event that a request is not approved.

39. The Government will also adopt by October 1, 1996 a decree that would (i) allow the sale of undeveloped land under state ownership to be sold by public auction without restriction on minimum prices; the identification of such land plots and administration of their sale will be the responsibility of the EPA in cooperation with county governments; and (ii) eliminate price controls on land surveys to help develop and deregulate this market. Under the decree, municipalities would be required to clarify with the EPA any zoning restrictions that could apply.

40. The Government continues to view the timely production of economic and financial statistics as critical to its ability to assess economic performance and to act quickly when new developments require a policy response, as well as to the ability of domestic and foreign investors to make enlightened economic choices. To that end, the authorities intend to subscribe to the IMF's Special Data Dissemination Standard (SDDS) during the course of 1996. For these reasons, the Government is committed to submitting the already long delayed draft Statistical Law to Parliament no later than September 15, 1996. Efforts to improve national accounts statistics in particular will continue, and the Government looks forward to receiving further technical assistance from the IMF in this area. Attention will also focus during the program period on three other areas: (i) the compilation of domestic and external debt statistics by various levels of government, for which we are receiving technical assistance from the World Bank; (ii) the production on a regular basis of consolidated data on general government operations. This will mainly be the responsibility of the Ministry of Finance, Disclosure obligations by local governments will be clarified and strengthened through legislation if necessary; and (iii) the compilation of reliable employment and unemployment statistics according to international standards and based on sample survey techniques, for which the Government will also seek technical assistance from the IMF.

IV. Performance Monitoring and Review

41. Progress with implementation of the economic program for 1996-97 will be monitored through quarterly quantitative performance criteria, structural benchmarks, and a mid-term review, satisfactory completion of which will be a performance criterion for end-December 1996. Quarterly quantitative performance criteria will apply to (i) net international reserves and currency board cover, as defined under the previous program; (ii) the overall deficit of the general government; (iii) limits on the net contracting or guaranteeing by the general government or the Bank of Estonia of all nonconcessional external borrowing with subceilings for borrowing of maturities of one to five years and a separate ceiling on the outstanding stock for borrowing of maturities of one year or less; and (iv) maintaining required reserves as defined under new regulations issued by the Bank of Estonia to 10 percent of eligible deposits. Further definition and quantification of performance criteria through end-December 1996 are provided in the Annex to this Memorandum. Performance criteria for end- March 1997 and end-June 1997 will be established during the mid-term review. Structural benchmarks covering reforms of the fiscal system, banking sector, and privatization are detailed in Table 1 of the Annex. Additional structural benchmarks for 1997 may be set at the time of the mid-term review. In addition to

assessing the overall economic and policy performance, the mid-term review of the program, to be completed before March 15, 1997, will focus on: (i) structural reforms of the public expenditure system in the context of the 1997 budget and government revenue performance; (ii) improvement in the financial position of the NEB and progress in restructuring/liquidating of other weak financial institutions; (iii) consistency of the reference prices regime with WTO regulations; and (iv) progress in land privatization and in the restructuring and privatization of the electricity and oil shale companies.

APPENDIX IV
ANNEX

Annex to the Memorandum of Economic Policies of the Government and Bank of Estonia

Implementation of the economic program for 1996-97 will be monitored through performance criteria and structural benchmarks.

1. Performance Criteria

Overall Deficit of the General Government

Overall Deficit Ceilings	(In millions of kroons)
January 1, 1996 - June 30, 1996 (indicative)	330
January 1, 1996 - September 30, 1996	630
January 1, 1996 - December 31, 1996	720
January 1, 1997 - March 31, 1997 (indicative)	--

General government operations encompass the budgets of the central government, the extrabudgetary funds, and local governments. The extrabudgetary funds include, but are not limited to the Social Insurance, Medical Insurance, and Environment Funds.

The general government overall fiscal deficit is defined as being equivalent to the sum of net credit to general government from the domestic and foreign banking systems, net credit from other financial and nonfinancial institutions or households, and net foreign loans disbursed to general government.

Net credit to general government from domestic and foreign banking systems is defined as the change in total claims of domestic and foreign banks on the general government less the change in the liabilities of these banks to general government. Claims of domestic and foreign banks on the general government include: (a) domestic and foreign bank loans to general government; (b) securities or bills'issued by the general government held by domestic and foreign banks; and (c) overdrafts on the current accounts of the general government with domestic and foreign banks. The liabilities of the general government with domestic and foreign banks include, but are not limited to: (a) money deposits of the general government with domestic and foreign banks; and (b) securities issued by domestic or foreign banks held by the general government.

Credit to general Fovernment from other financial and nonfinancial institutions or households is defined as all increases in domestic claims on general government outside the banking system. In particular, it includes securities, bonds, and other debt issued by general government institutions and held by nonfinancial enterprises and households.

Net foreign loans disbursed to general government comprise total disbursements of all government and government-guaranteed nonbank loans, including purchases from the IMF under the STF, less repayments of such loans (but excluding purchases from the IMF under the Stand-by Arrangements).

This definition excludes government-guaranteed foreign loans disbursed directly to entities outside general government.

Data on net claims of the domestic banking system on general government, in the agreed format, will be reported to the Fund within 30 days of the end of each month by the Bank of Estonia. The Ministry of Finance shall confirm these data. The Ministry of Finance and the Bank of Estonia shall report monthly data on general government gross balances held with the foreign banking system, general government gross liabilities to the foreign banking system, disbursements and repayments of foreign loans to the general government, blocked accounts held with the domestic and foreign banking systems, net lending operations, and any other data regarding general government financial operations.

Net International Reserves and Currency Board Cover

Minimum Limits on Net International Reserves	(In millions of deutsche mark)
December 31, 1995 (actual stock)	99.5
June 30, 1996 (indicative)	95.7
September 30, 1996	98.5
December 31, 1996	103.9
March 31, 1997 (indicative)	110.3

Net international reserves consist of gross reserves of the Bank of Estonia, minus net liabilities of the Bank of Estonia including currency board liabilities. These assets and liabilities will be converted to deutsche mark at current exchange rates defined as the official rates of the Bank of Estonia prevailing at each test date.

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 gross reserves of the Bank of Estonia are capital subscriptions to foreign financial institutions, long-term non- financial assets of the Bank of Estonia, and any assets in nonconvertible currencies. Also excluded are assets held abroad by public enterprises and general government (including foreign exchange balances of the Government corresponding to purchases from the Fund). For the period of the program, monetary gold will be valued at DM 554.53 per ounce. Fund staff will be informed of details of any gold sales, purchases or swap operations, and changes in the measurement of gross reserves that arise merely from a different valuation of gold. On December 31, 1995, gross reserves, as defined above, amounted to EEK 6,683.5 million (equivalent to DM 835.4 million), including gold holdings valued at EEK 36.6 million (equivalent to DM 4.57 million).

For the purposes of the program, net liabilities of the Bank of Estonia shall be defined as the Bank of Estonia's total liabilities, excluding Estonia's quota in the IMF (and excluding the capital accounts of the Bank of Estonia). Government obligations associated with Fund purchases under the STF will not be included among the net liabilities of the Bank of Estonia. On December 31, 1995, net liabilities of the Bank of Estonia as defined here amounted to EEK 5,890.O million (equivalent to DM 736.25 million).

The above targets will be adjusted downward by the maximum amount of DM 12.5 million (EEK 100 million) in connection with the Bank of Estonia undertaking emergency lending operations to commercial banks where bank illiquidity is posing a systemic risk.

Also as a performance criterion, the Bank of Estonia will ensure that gross foreign reserves of the Bank of Estonia are at least equal to the currency board's liabilities at all times. Currency board liabilities will comprise kroon notes and coins in circulation, total reserve deposits of banks (including the Savings Bank) with the Bank of Estonia, certificates of deposit issued by the Bank of Estonia and kroon liabilities of the Bank of Estonia in its correspondent accounts. For the purposes of this performance criterion, currency board liabilities will be expressed in terms of foreign exchange using the official exchange rate of 8 kroons per deutsche mark. On December 31, 1995, currency board liabilities amounted to EEK 5,125.3 million (equivalent to DM 640.6 million).

Performance will be monitored from information supplied monthly by the Bank of Estonia in the agreed format. The monthly data will be provided to the Fund within the seven days of the end of each month throughout the program period.

Ceilings on Contracting or Guaranteeing
of New Non-Concessional External Debt

Debt ceilings	(In millions of U. S. dollars)		
		Ceilings	
	One year and under	Over 1 year	1-5 years
Cumulative changes from December 31, 1995:			
June 30, 1996 (indicative)	--	100	80
September 30, 1996	--	120	80
December 31, 1996	--	150	100
March 31, 1997 (indicative)	--	200	120

The ceilings apply to the contracting or guaranteeing by the Government and the Bank of Estonia of new non-concessional external debt with an original maturity of more than one year; and within this limit, with an original maturity of more than one year and up to and including 5 years. Concessional loans are defined as those with a grant element of at least 35 percent of the value of the loan, using currency-specific discount rates based on the commercial interest rates reported by the OECD (CIRRs). The average CIERs over the last ten years will be used as discount rates for assessing the concessionality of loans of a maturity of at least 15 years. For loans with shorter maturities the average CIRRs of the preceding six- month period (August 15 to February 14) will be used. In addition, during the program period, neither the Government nor the Bank of Estonia shall contract or guarantee debt of an original maturity of one year or less, other than normal import financing. Liabilities on interstate correspondent accounts shall be considered normal import financing.

The Government is defined as comprising the state and local authorities, and all extrabudgetary funds. Excluded from the limits is the use of Fund resources; but other balance of payments support, including loans from official creditors and foreign banks, is included within these limits. The amount of debt contracted or guaranteed will be valued at the relevant currencies of denomination and converted into U.S. dollars using the Bank of Estonia's official exchange rates prevailing at the time the debt is contracted.

Compliance with the limits shall be verified for the dates shown above. Information on net contracting, guaranteeing and disbursements of external debt in the agreed format will be reported monthly to the Fund within 30 days of the end of each month by the Ministry of Finance.

Reserves of the Banking System

As a performance criterion, eligible assets of the banking system will not be below the required reserves of the banking system by more than 1 percent of average eligible liabilities during the quarter ending June, September, and December 1996, and ending March and June 1997.

Eligible assets of the banking system shall include demand deposits held at the Bank of Estonia and the domestic currency component of vault cash. For the purposes of calculating eligible assets of the banking system, the share of the demand deposits at the Bank of Estonia in the total eligible assets will not be below 6 percent of eligible liabilities. Any amount of vault cash in excess of 40 percent of total eligible assets shall not be included in the calculation of the total eligible assets.

Required reserves of the banking system will not be reduced to below 10 percent of eligible liabilities during the program period. Eligible liabilities of the banking system shall include domestic and foreign currency demand deposits, time deposits, savings deposits, and other deposits of individuals, nonbank financial institutions, nonfinancial institutions, and general government. Required reserves of the banking system for each quarter will be calculated from the banking survey for each month of the quarter.

Mid-Term Review

A review of performance under the program, including as regards the 1997 budget, progress with bank restructuring, trade policy, and enterprise and land privatization, shall'be completed before March 15, 1997.

2. Structural benchmarks

The main structural measures of the program constitute structural benchmarks and are summarized in Table 1.

Table 1: Structural Benchmarks

Measure	Date/period of implementation
I. Budgetary and pension policies	
Introduction in Parliament of amendments to legislation on Municipalities and Towns and on Taking Foreign Loans, tightening the requirements on local government borrowing	September 15,1996
Submission to Parliament of new Pension and Social Tax Laws	November 1, 1996
Development of National Audit Plan and strengthening of audit procedures	Starting fall of 1996
Introduction of legislation requiring proper bookkeeping by enterprises for VAT	October 1, 1996
Strengthening of collaboration between National Tax Board and Customs Administration	From June 1996
Request for World Bank assistance in conducting a public expenditure review	Before end-1996
II. Financial sector	

Any necessary amendments made to Credit Institutions Act, in particular to allow exchange of information between supervisory authorities and external auditors	November 1, 1996
Increase in the minimum capital requirement of commercial banks to EEK 60 million	January 1, 1997

III. Pricing and regulatory policy

Increase in electricity price to EEK 0.45/kwh (and corresponding increase in oil shale prices); further price adjustments to cover increasing share of long-run generation costs	June 1, 1996; and from beginning of 1997
Submission to Parliament of amendment to Price Law establishing a Monopoly Regulatory Board	Before end-1996
Start up of Monopoly Regulatory Board Operations	March 1997
Submission to Parliament of amendments to Competition Law strengthening the Competition Board	March 1, 1997

IV. Trade policy

Equalization of excises on all domestic and imported goods completed	December 1, 1996
Elimination of reference prices for all imports	June 1, 1997

V. Land reform/restructuring

Passage by Parliament of amendments to Land Reform Law	April 30, 1996
Issuance of government decree requiring municipalities to follow accelerated procedures for privatisation of land linked to enterprise sales	August 1, 1996
Issuance of government decree defining procedures to speed up sales of undeveloped land	October 1, 1996
Restructuring of balance sheet of Eesti Energia and Eesti Polevkivi completed	January 1, 1997

VI. Statistics

Submission to Parliament of Statistical Law	September 15, 1996

APPENDIX V

Estonia: Fund Relations

(As of May 31, 1996)

I. Membership Status: Joined 5/26/92; Article VIII

II. General Resources Account:	SDR Million	% Quota
Quota	46.50	100.0
Fund holdings of currency	106.70	229.5
Reserve position in Fund	0.01	--

III. SDR Department:	SDR Million	% Allocation
Holdings	0.11	---

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Stand-by arrangements	36.96	79.5
Systemic Transformation	23.25	50.0

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved SDR Million	Amount Drawn SDR Million
Stand-by	4/11/95	7/10/96	13.95	--
Stand-by	10/27/93	3/26/95	11.63	11.63
Stand-by	9/16/92	9/15/93	27.90	27.90

VI. Projected Obligations to Fund : based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	4/30/96	1996	1997	1998	1999	2000
Principal	--	6.1	14.1	12.9	7.6	5.0
Charges/Interest	--	1.3	2.2	1.6	1.1	.8
Total	--	7.4	16.3	14.5	8.7	5.8

VII. Exchange Rate Arrangement :

The currency of Estonia is the kroon. The kroon replaced the ruble on June 20, 1992. Since that date, the Bank of Estonia has guaranteed the conversion of kroon bank notes, coins, and reserve deposits of commercial banks at a fixed rate of exchange of EEK 8 per deutsche mark. The kroon is fully convertible for all current and capital international transactions.

VIII. Article IV Consultations

The 1995 Article IV consultation was concluded by the Executive Board on April 11, 1995.

IX. Technical Assistance

The attached table provides information on the Fund's technical assistance activities in Estonia.

X. Resident Representative

The second resident representative of the Fund in Estonia, Mr. Basil Zavoico, took up his post in Tallinn in July 1994.

Estonia: Technical Assistance, 1993-95

Department	Subject/Identified Need	Action	Timing	Counterpart 1/
			1993	
MAE	Banking supervision and central bank accounting	Visit	July	BOE
STA	Monetary statistics	Visit	August	BOE
MAE	Central bank accounting	Two-month assignment	September/October	BOE
STA	Consumer and producer price index	Visit	October	BOE
STA	Monetary statistics	Visit	October	BOE
			1994	
FAD	Tax policy	Mission	January	MOF
FAD	Tax administration	Visit	January	MOF
STA	Government finance statistics	Mission	January	MOF
MAE	Banking supervision	Visit	January	BOE

STA	Balance of payments statistics	Mission	March	BOE
MAE	Review of banking supervision, accounting, and monetary statistics and analysis	Mission	March	BOE
FAD	Tax administration	Visit	March	MOF
STA	Producer price index	Visit	April	BOE/SOE
FAD	Tax administration	Visit	May	MOF
FAD	Tax policy	Visit	June	MOF
STA	National accounts statistics	Mission	Sptember	SOE
FAD	Tax administration	Visit	September	MOF
			1995	
MAE	Banking Supervision	Mission	January	BOE
FAD	Tax administration	Visit	March	MOF
FAD	Tax policy	Mission	April	MOF
MAE	International reserve management	Mission	April	BOE
FAD	Tax policy and administration	Mission	August	MOF
MAE	Banking supervision and monetary analysis	Mission	November	BOE

Source : International Monetary Fund.

1/ BOE: Bank of Estonia; MOF: Ministry of Finance; SOE: Statistical Office of Estonia.

APPENDIX VI

Estonia: Relations with the World Bank

Estonia became a member of the World Bank on June 23, 1992. The first Bank study, a country economic memorandum (CEM) entitled "Estonia--The transition to a Market Economy", provided a comprehensive overview of the Estonian economy following independence. The study was followed by a series of policy notes that provided advice to the Government on various macroeconomic and structural reform issues. In 1994, the Bank prepared a Public Expenditure Review that was discussed with the Government and other donors in May 1994, and published in July 1994. The Review formed the basis for further work on the development and implementation of the Government's Public Investment Program. In 1995, the Bank concluded a study on Local Government Financing that reviewed the country's program of fiscal decentralization. The report focussed on revenue and expenditure assignment among different levels of government, local governments' investment program and borrowing by sub-national governments. In 1996, the Bank finalized a report on Living Standards During the Transition. The report assessed the impact of the economic transition on living standards, examining the potential for improvements in living standards under the ongoing economic recovery and policy options to bridge the remaining poverty gap.

The first World Bank lending operation in Estonia, a Rehabilitation Loan for US$30 million, was approved by the Board of Executive Directors of the Bank in October 1992. The Loan aimed to support the Government's reform program and to help maintain output in key sectors. A USS38.4 million District Heating Rehabilitation Loan was approved by the Bank's Board of Executive Directors in May 1994. The main objective of this loan is to increase energy efficiency and improve environmental conditions. In May 1994, a Highway Maintenance Loan (US$12 million) was also approved, with the main objective of preserving the Estonian road network and avoiding costly rehabilitation or reconstruction in the future. The Bank's Board of Executive Directors also approved a US$lO million Financial Institutions Development Loan (FIDL) in October 1994, with the objective to support Government's implementation of reforms in the enterprise and financial sector. A Health Project (US$18 million) was approved in January 1995 with the objective of improving the health of the Estonian people through health sector reform. An Environment Loan (US$2 million) to improve environmental quality in the Haapsalu and Matsalu Bays was approved by the Board in April 1995. And an Agriculture Loan (US$16 million) that supports the Government's efforts to promote rural entrepreneurship, private ownership, technical transformation of production systems, and to establish rural land market was approved by the Bank's Board in March 1996.

APPENDIX VII

Estonia--Statistical Issues

1. Outstanding statistical issues

a. Real Sector

Substantial progress has been made in all areas of real sector statistics, particularly, in price statistics. However, weaknesses remain in the measurement of private sector activity and in estimates of external trade. The major concern is. the low response rate to an enterprise survey conducted by the Statistical Office of Estonia (SOE).

A country page for Estonia was introduced in the May 1995 issue of IFS and official reporting by Estonia for publication in DOTS began in March 1995. However, Estonia has not reported real sector data on a regular basis since the inception of the IFS country page. In addition, recent reporting for DOTS has been irregular. It would be useful if the authorities would provide the official data produced by the SOE on a regular and timely basis.

b. Government finance

Estonia has made good progress in reporting to the Statistics Department of the Fund (STA) annual government finance data for the consolidated central government and for local governments for publication in Government Finance Statistics Yearbook (GFSY): However, the GFS compiler at the Budget Office uses an incomplete coverage of lending minus repayments operations originating from foreign loans (on-lent funds) and STA had to be authorized to use lending minus repayments data compiled by the European II Department. There is a need for the GFS compiler to receive complete data on government operations that do not take place through the budget. The economic classification of expenditures is inadequate. The authorities have also been encouraged to report monthly data on central government operations for publication in IFS.

c. Monetary accounts

Monthly data are reported for IFS publication in a timely fashion. In the June 1996 issue of IFS, money and banking data are current through March 1996. There are no statistical issues outstanding.

d. Balance of payments

Estonia is a quarterly reporter; balance of payments data through the first quarter of 1995 have been reported to STA and are published in IFS. Data need to be reported in a more timely manner and on a more current basis.

Survey of Reporting of Main Statistical Indicators
As of end-May 1996

Country: Estonia

	Exchange rates	International reserves	Reserve / base money	Central Bank balance sheet	Broad money	Interest rates	Consumer price index	Exports / imports	Current account balance	Overall government balance	GDP / GNP
Date of latest observation	05/31/96	05/31/96	05/31/96	05/31/96	04/30/96	May 96	Apr. 96	Q1 96	Q4 96	Q4 95	Q2 1995
Data received	05/31/96	06/10/96	06/10/96	06/10/96	05/27/96 3/	05/20/96	06/04/96	06/03/96	06/11/96	Mar. 96 4/	Mar. 96
Frequency of data	D	M	M	M	M	M	M	M	Q	Q	Q
Frequency of reporting	D	M	M	M	M	M	M	M	Q	Q	Q
Source of data	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting	O 1/	O 1/	O 1/	O 1/	O 1/ 3/	O 1/	C 2/	O 1/	O 1/	C, V 2/ 4/	C, V 2/
Confidentiality	C	C	C	C	C	C	C	C	C	C	C

Explanatory notes

Frequency of data: D-daily, W-weekly, M-monthly, Q-quarterly.
Frequency of reporting: M-monthly, Q-quarterly, V-irregularity in conjunction with staff visits.
Source of data: A-direct reporting by central bank, ministry of finance, or other official agency, N-official publication or press release.
Mode of reporting: C-cable of facsimile, V-staff visits, or O-other (please explain).
Confidentiality: (B) for use by the staff and the Executive Board, (C) for unrestricted use.

1/ Via electronic mail
2/ Through the resident representative's office
3/ Broad money computed by staff based on balance sheets received (consolidated commercial banks balance sheet and central bank balance sheet).
4/ General government balance computed by staff based on separate data provided by the Ministry of Finance.

APPENDIX VIII

Estonia--Stand-By Arrangement

Attached hereto is a letter, with an annexed memorandum of economic policies dated June 18, 1996 from the Prime Minister of Estonia and the Governor of the Bank of Estonia, requesting a stand-by arrangement and setting forth:

(a) the objectives, policies and measures that the authorities of Estonia intend to pursue for the period of this stand-by arrangement; and

(b) understandings of Estonia with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Estonia will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from July . . . . 1996 to August . . . . 1997, Estonia will have the right to make purchases from the Fund in an amount equivalent to SDR 13.95 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 2.79 million until November 15, 1996, the equivalent of SDR 5.58 million until February 15, 1997, the equivalent of SDR 8.37 million until May 15, 1997, and the equivalent of SDR 11.16 million until August 15, 1997.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Estonia's currency subject to repurchase beyond 25 percent of quota.

3. Estonia will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Estonia's currency subject to repurchase beyond 25 percent of quota:

(a) during any period in which the data at the end of the preceding period indicate that

(i) the limit on the overall deficit of the general government, or

(ii) the floor for net international reserves of the Bank of Estonia, or

(iii) the minimum level for total reserve holdings of deposit money banks, or

(iv) the limit on nonconcessional external debt contracted or guaranteed by the Government or the Bank of Estonia with maturities of up to and including one year, or

(v) the limit on nonconcessional external debt contracted or guaranteed by the Government or the Bank of Estonia with maturities of over one year, or

(vi) the limit on nonconcessional external debt contracted or guaranteed by the Government or the Bank of Estonia with maturities of over one year and up to and including five years,

specified in the Section 1 of the Annex to the Memorandum of Economic Policies of the Estonian Authorities is not observed; or

(b) if at any time during the period of the arrangement

(i) the Government accumulates external payments arrears, or

(ii) the gross foreign reserves of the Bank of Estonia fall below the Currency Board's liabilities as specified in Section 1 of the Annex to the Memorandum of Economic Policies of the Estonian Authorities

is not observed; or

(c) after February 14, 1997 until the review contemplated in paragraph 4 of the attached letter is completed, or

(d) if at any time during the period of the stand-by arrangement, Estonia

(i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions; or

(ii) introduces or modifies multiple currency practices; or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Estonia is prevented from purchasing under this stand-by arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Estonia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Estonia will not make purchases under this stand-by arrangement 'during any period in which Estonia has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation (a) in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action, or (b) in respect of a purchase in support of debt and debt service reduction operations.pursuant to Decision No. 9331- (89/167), as amended, or (c) pursuant to subparagraph 16(a) or 33(a) of Decision No. 8955-(88/126), as amended, on the Compensatory and Contingency Financing Facility.

5. Estonia's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Estonia. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Estonia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Estonia, the Fund agrees to provide SDRs at the time of the purchase.

7. Estonia shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

8. (a) Estonia shall repurchase the amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Estonia's balance of payments and reserve position improves.

(b) Any reductions in Estonia's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

9. During the period of the stand-by arrangement Estonia shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Estonia or of representatives of Estonia to the Fund. Estonia shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Estonia in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

10. In accordance with paragraph 4 of the attached letter, Estonia will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not

been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Estonia has outstanding purchases in the upper credit trances, the government will consult with the Fund from time to time, at the initiative of the government or at the request of the Managing Director, concerning Estonia's balance of payments policies.