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Deloitte & Touche

Republic of Estonia

Phase II Report

Volume 1

In Association With:
Development Alternatives, Inc.
Geonomics Institute
Milbank, Tweed, Hadley & McCloy
Multinational Strategies, Inc.

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Eastern Europe Enterprise Restructuring and Privatization Project

U.S. Agency for International Development
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EXECUTIVE SUMMARY

Introduction

This is the final report of Deloitte & Touche's project to provide technical assistance to the Government of Estonia in developing a privatization strategy. The project was funded by the U.S. Agency for International Development (A.I.D.) as a delivery order under the Eastern Europe Economic Restructuring and Privatization Project, and was conducted during the period October 1, 1991 to May 15, 1992.

The focus of the Estonia privatization project has changed since issuance of the original delivery order. The original delivery order called for a strategic study delineating privatization options that might be pursued by the Government of Estonia (GOE). The Deloitte & Touche consortium fielded a team for two weeks in the first half of November to assess the status of privatization in Estonia and to identify the technical assistance needs of the GOE in privatization. The team's Phase I findings and recommendations concerning technical assistance were incorporated in the Phase I Report, submitted December 16, 1991. In this report, we concluded that the GOE had already developed some of the fundamental policy and planning framework for privatization, and recommended replacing the strategic study with several specific technical assistance tasks to be conducted in Phase II of the project. These tasks were to be directed at specific targets such as providing a clear and stable legal and regulatory environment for investment, establishing administrative mechanisms to support privatization, and devising privatization strategies for specific industries.

In late December, A.I.D. approved four tasks for Phase II. The project team conducted these tasks during the period January 6 - May 15, producing nine separate deliverables. Production and submission of each of the deliverables were timed to coincide with the policy development process in the GOE, resulting in a high level of attention from key policy officials in Estonia.

Following this introduction, we summarize our recommendations concerning future privatization efforts in Estonia, noting those areas in which further technical assistance would be appropriate. We then briefly describe each of the project deliverables under *Summary of Accomplishments of the Delivery Order*. In a separate section of this volume, we describe the methods used and detail the activities and staffing for the delivery order.

Summary of Recommendations for Future Assistance

In the section below, we have summarized and integrated the project team's major recommendations from all of the tasks and deliverables. These are organized into four major categories:

- governance and national policy-making
- institution building
- implementation of privatization
- new legislation

We have marked with an asterisk priority areas for continued technical assistance.

1. Governance and National Policy-making

The following process-oriented improvements will enhance the effectiveness of government efforts during the transition to a free market economy.

Legislative Process

* Establish a seminar-based process making use of Western legal experts to develop new legislation and revise existing legislation

Establish a system to provide easy access in Estonian and English to existing and proposed legislation, decrees and orders and to codify Estonian legislation and regulations

Budget Process

Formalize the budget process with identification of needs starting at the ministry level

Government Operations

Establish bilateral tax treaties, preferably including "tax sparing" provisions, with as many countries as possible

2. Institution Building

In the course of our advisory work, we have identified the following needs for strengthening of administrative units of the government.

Ministry of Economy and State Property Board

* Computerize the asset sale tracking functions of the State Property Board

* Establish a voucher system administration unit in the Ministry of Economy

Ministry of Agriculture

* Restructure the Ministry to deliver information gathering and dissemination, policy-setting, and rural development functions

* Establish a national agricultural extension service

3. Implementation of Privatization

We have organized our privatization strategy recommendations below by type of enterprise, with additional recommendations for financing and administration of privatization.

Restructuring and Sale of Large Enterprises

* Restructure large, non-viable enterprises into a number of small and medium sized firms along the borders of different technologies

* Offer small firms that are divested from larger enterprises to their current management and workers, or put them up for bid

* Establish a mutual fund scheme for sale or free distribution of shares in state enterprises that are viable

Privatization and Development of Small-Scale Industry

* Establish a voucher-based privatization mechanism for small industry

* Provide state-sponsored technical assistance to small firms, including new firms formed out of the breakup of larger enterprises

Privatization and Development of Agriculture

* Establish a national oversight mechanism for agricultural asset privatization commissions

* Begin establishing a nation-wide information data bank

Avoid breaking up large farms into units that are too small for commercial viability

Financing of Mass Privatization

* Provide state-sponsored technical assistance to banks in the area of consumer banking functions to assist in the financing of state asset sales

Administration of Mass Privatization

* Develop an automated system to assist in the administration of the government's free asset distribution program

4. New Legislative

We have grouped recommended new legislation in three categories: a) general legislation required in any market economy, but currently nonexistent in Estonia; b) new legislation governing the process by which state assets are transferred to the private sector; c) new programs requiring enabling legislation that will assist in the transition to a free market economy. We have subdivided

each category by priority: "near term" (as soon as possible); and "medium term" (within the next year).

a. General Legislation

Near Term

New Constitution
- Due process
- Equal protection
- Abridgement of contract
- Ex post facto laws
- State takings

* Core Free Market Legislation
- Commercial code/contracts
- Restitution
- Security interest in personal and real property
- Bankruptcy
- Intellectual property

Other
- Currency Reform

Medium Term

Judicial and Administrative System
- Establishment of bankruptcy courts and procedures
- Code of civil procedure
- Arbitration laws and procedures
- Administrative procedures
- Ethics in government
- Government procurement

* Regulation of Private Economic Activity
- Competition
- Securities
- Insurance
- Investment trust/mutual fund

Fundamental State Functions

- Environmental protection
- Consumer protection

b. Privatization Legislation

Near Term

* Lease-to-market farm privatization

* Homestead

* Property reform through use of vouchers

Medium Term

Sectors and enterprises reserved from privatization

Concessions and the exploitation of natural resources on state-owned land

c. New Government Programs

Medium Term

* State-financed credit for purchase of housing units

* State-financed credit for purchase of shares in enterprises

* An agricultural income support program to assist in the transition to a free market economy in agriculture

* Rural development: promotion and financing of small and medium-sized enterprises

Summary of Accomplishments of the Delivery Order

1. Description of deliverables

Each deliverable is briefly described below, including a summary of its content and method of preparation, and major recommendations.

Deliverable 1 - Legislative Assistance Report

This report describes the activities and results of a legislative assistance team effort conducted by attorneys from Milbank, Tweed, Hadley & McCloy. The report was prepared after collection and review of existing Estonian laws, consultation with Estonian Parliament and Ministry of Justice officials, and comparison of the Estonian laws with laws of other Eastern European countries.

The report covers three topics. First it suggests methods for improving the ability to identify and disseminate the existing body of statutory law, specifically that the *Riigi Teataja*, a government publication, be broadened to include information about parliamentary proceedings, agendas, matters being developed for parliamentary consideration, as well as regulations and orders issued or being considered by governmental ministries.

Next the report identifies areas in which further statutory development is required to support privatization. The most important gaps identified in the existing statutory framework are the subjects of contracts, property, secured interests in real and personal property, commercial transactions, corporations, bankruptcy, banking, accounting, competition and capital markets. Finally, the report recommends the adoption of a process that utilizes an interactive approach to draft legislation.

Project team members working on this deliverable included Stanley Marcuss, Richard Bernard, Christopher Ryder, and Philip von Mehren.

Deliverable 2 - Budget Process Memorandum

This memorandum describes laws and processes used by the United States government to control spending of, and develop a budget for, agencies of the federal government. The memo was written by Dr. Randall Weiss of the National Tax Office of Deloitte & Touche, at the request of Estonian Parliament officials who are responsible for establishing procedures to bring the country's budget under control. Several components of U.S. budget procedures could be emulated by Estonia, including:

- laws of two types, authorization laws which establish government agencies and programs and appropriations laws which allow agencies to incur obligations to spend money;

- the coordinating functions and oversight role of the Office of Management and Budget, an executive branch agency which oversees the budget process, allocates appropriated funds to the various agencies, and collects budget requests from each agency in planning a unified government budget for the upcoming budget year;

- post-spending review by the Treasury Department, which makes the payments that discharge the obligations of each agency, and the General Accounting Office, which sets accounting standards for tracking government funds.

Deliverable 3 - Agriculture Policy Report

This is an assessment of current efforts to privatize Estonian agriculture. The report recommends a method for privatization and methods for enacting law and procedures to implement privatization. The report was prepared by Dr. Michael Claudon of Geonomics Institute and Ivar Raig, an Estonian agricultural economist, after meeting with Estonian officials and farmers and on-site review of on-going privatization projects in Estonia.

The report concludes that legislation is needed to govern contracts and specify steps for actually implementing (in contrast to authorizing) privatization. A specific goal is to prevent the emergence of small-scale farms as existed before the Communists gained power in Estonia. Farming should follow the large-scale U.S. model in scale, but not necessarily in form. Recommended strategies include leasing farms to farmers as a way of transferring ownership, modifying

the role of the Ministry of Agriculture, and provision of subsidies and financing to farmers to enable them to compete with Western commodities until privatization has been completed.

Deliverable 4 - Tax Policy Memoranda

At the request of the Deputy Minister of Finance of Estonia, Dr. Emil Sunley of the National Tax Office of Deloitte & Touche prepared three memos relating to taxation of investment income and foreign companies. Two of the memos, dealing specifically with tax treaties and transfer pricing, were submitted in advance, and then discussed during Dr. Sunley's visit, which took place March 16-25. The tax treaty memo recommends that Estonia sign mini-treaties with as many countries as possible. Actual tax treaties signed by Denmark, Sweden, & Germany were provided as examples. The transfer pricing paper describes the principles and basic issues in transfer pricing, the goal of the U.S. law, and the difficulties in determining a market-based transfer price.

A third memo on tax holidays was prepared during the visit. It recommends that Estonia establish a broad tax base and low tax rates, and avoid tax holidays and special incentives.

Deliverable 5 - Investment Restrictions Report

This report is a survey of the restrictions placed on foreign investment by governments of thirteen developing countries. The report was prepared in the United States, at the request of the Estonian Department of Foreign Economic Relations, by Richard Wolfe and James Folino of Deloitte & Touche, primarily using secondary sources. It is apparent from the survey that countries achieving robust economic growth typically have simple and minimal restrictions on foreign investment.

Deliverable 6 - Draft law on Limited Liability Companies

This draft law was prepared by Jenik Radon, an attorney and consultant to Geonomics Institute, at the request of the Estonian Ministry of Justice and Legal Committee of the Supreme Council. It addresses one of the priority legislative needs identified in the legislative agenda.

Deliverable 7 - Electronics Industry Privatization Strategy

This report describes the electronics industry in Estonia and suggests a strategy for privatization of large, multi-technology enterprises. The report was written by Dr. John Brown of Deloitte & Touche, and Daniel Hogan of Development Alternatives, at the request of the Estonian Ministry of Industry and Energy. The report is based on information provided by representatives of 16 Estonian electronics enterprises, and site visits to most of these enterprises. The recommended approach to privatization of these enterprises is to restructure them into smaller firms along the lines of the different technologies, granting ownership to private individuals, especially managers and employees of the production units that are divested.

Task 8 - Electronics Industry Investor Guide

This booklet identifies and briefly describes most of the major enterprises that produce electronics products or services in Estonia. It is intended to serve as an introduction to Estonian electronics enterprises for foreign investors and other interested parties. The guide was prepared by Anne Nisenson and James Folino of Deloitte & Touche, based on information collected by John Brown and Daniel Hogan.

Task 9 - Voucher System Conceptual Design

This report recommends and describes an automated voucher system to manage and track the free distribution of state assets to the Estonian public. The proposed voucher system design is intended to support all of the free asset distribution programs currently planned by the Estonian Government, including mass privatization of housing and shares in large enterprises, compensation for seized assets, and decollectivization of agricultural land and other productive assets. The recommended design is based on interviews with government officials in Estonia and on previous voucher system experience gained elsewhere in Eastern Europe. It includes recommendations for using the Estonian banking system to implement a credit program for purchase of housing.

The report was prepared by Richard Wolfe and Anne Nisenson of Deloitte & Touche, and Gail Buyske of Multinational Strategies. Cliff Dean of the London office of Touche Ross assisted in the system design.

2. Other Accomplishments

The project team conducted three seminars as part of the delivery order:

- a half-day seminar on voucher systems conducted by the voucher design task team for Ministry of Economy personnel on February 20;

- a one-day seminar on tax treaties for Ministry of Finance personnel, conducted by Emil Sunley on March 18, at the request of the Deputy Minister;

- a seminar on stock exchange law, conducted by Richard Bernard during the week of April 27, attended primarily by private sector representatives of the private sector and government officials, many of whom sit on a government council delegated with the task of drafting a securities law.

DESCRIPTION OF WORK PROGRAM

Activities and Staffing

Phase I - Privatization Assessment

A four-person team consisting of an economist/project manager, capital markets specialist, and two attorneys visited Tallinn, Kohtla-Jarve, and Narva during the period November 4-15, 1991. The project team conducted interviews with 11 government organizations, 6 enterprises and banks, and 6 private sector organizations and institutions. On November 26, 1991, the project team met with the A.I.D. Project Officer in the Deloitte & Touche offices in Washington, D.C., to review the results of the assessment visit. Based on the comments and guidance of the Project Officer, the team prepared a report summarizing its findings and recommendations concerning technical assistance, and submitted them as the Phase I Report on December 16, 1991.

Phase I activities required a total of 50 person days of effort. Staffing, schedule and level of effort details by team member are shown in Exhibit 1.

Phase II - Technical Analyses

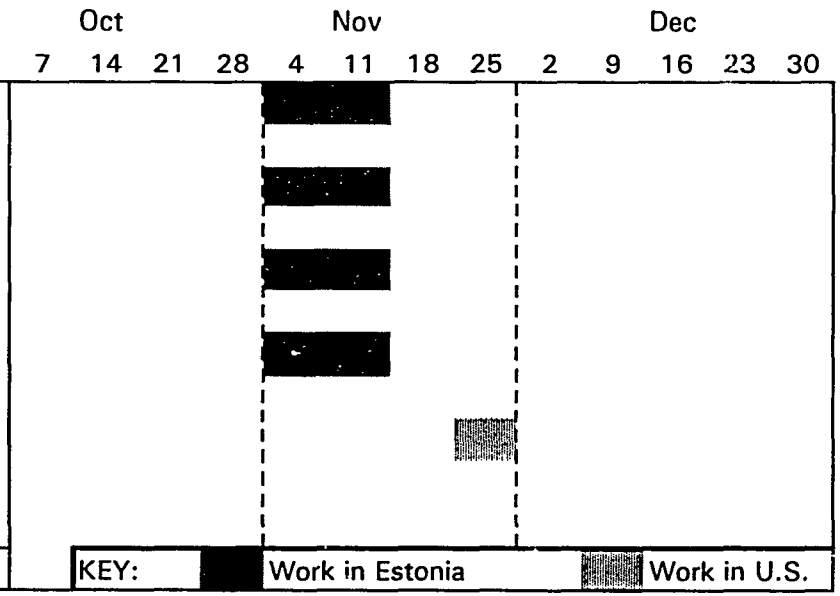
In Phase II, the project team conducted four sets of technical analyses:

Task 1 :	Assistance to the legislative branch in privatization policy development;
Task 2 :	Development of a strategy for restructuring and privatizing the electronics industry;
Task 3 :	Policy advice in taxation of investment income and foreign companies; and
Task 4:	Design of a voucher system for managing and tracking free distribution of state assets.

Each analysis resulted in one or more reports, policy memoranda, directories, or draft laws. A summary of the deliverables produced under these four tasks is presented in the preceeding executive summary under *Summary of Accomplishments of the Delivery Order.*

EXHIBIT 1
Estonia Phase I: Privatization Assessment
Work Plan and Staff Phasing

STAFF	DAYS IN ESTONIA	DAYS IN U.S.	TOTAL DAYS
Richard Wolfe	12		12
Kenneth Angell	12		12
Christopher Ryder	12		12
Jerik Radon	10	2	12
Michael Claudon		2	2
TOTAL	46	4	50



Phase II activities required an estimated total of 356.5 person days of effort. Staffing, schedule and level of effort details by team member are shown in Exhibits 2 and 3.

Methods of Work Used

In general, the work conducted under this delivery order consisted of field research in Estonia and preparation of reports based on the results of the research. Field research activities included interviews with officials of the Estonian Parliament and Government and with private sector representatives, tours of industrial facilities, and collection of data from diverse sources. The project team also conducted research in the United States on laws of other developing countries, and on relevant policies and procedures used in the United States Congress and Government. Reports were generally drafted and submitted in the field and finalized in the United States after review by GOE and A.I.D. officials.

Training Activities

No formal training activities were conducted under this delivery order. The project team conducted informal training through seminars, described above under *Summary of Accomplishments of the Delivery Order*.

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EXHIBIT 2

Estonia Phase II Work Plan and Staff Phasing - Revised 5/15/92

TASK	STAFF	EST. DAYS
i. Legislative Policy Assistance	**Ryder**	21
	Bernard	11
	V. Mehren	25
	Marcuss	2
	Weiss	10.5
	Radon	30
	Claudon	22
	Raig	6
	Wolfe	6
	Folino	12
	TOTAL	145.5
II. Electronics Industry Privatization Analysis	**Brown**	27
	Hogan	40
	Wolfe	6
	Nisenson	3
	Folino	9
	TOTAL	85
III. Taxation of Investment Income	**Sunley**	14
	TOTAL	14
IV. Voucher System	**Wolfe**	41.5
	Nisenson	20
	Buyske	14
	Dean	2
	Vickland	2.5
	TOTAL	80
MANAGEMENT	D&T	27
	Subs	5
	TOTAL	356.5

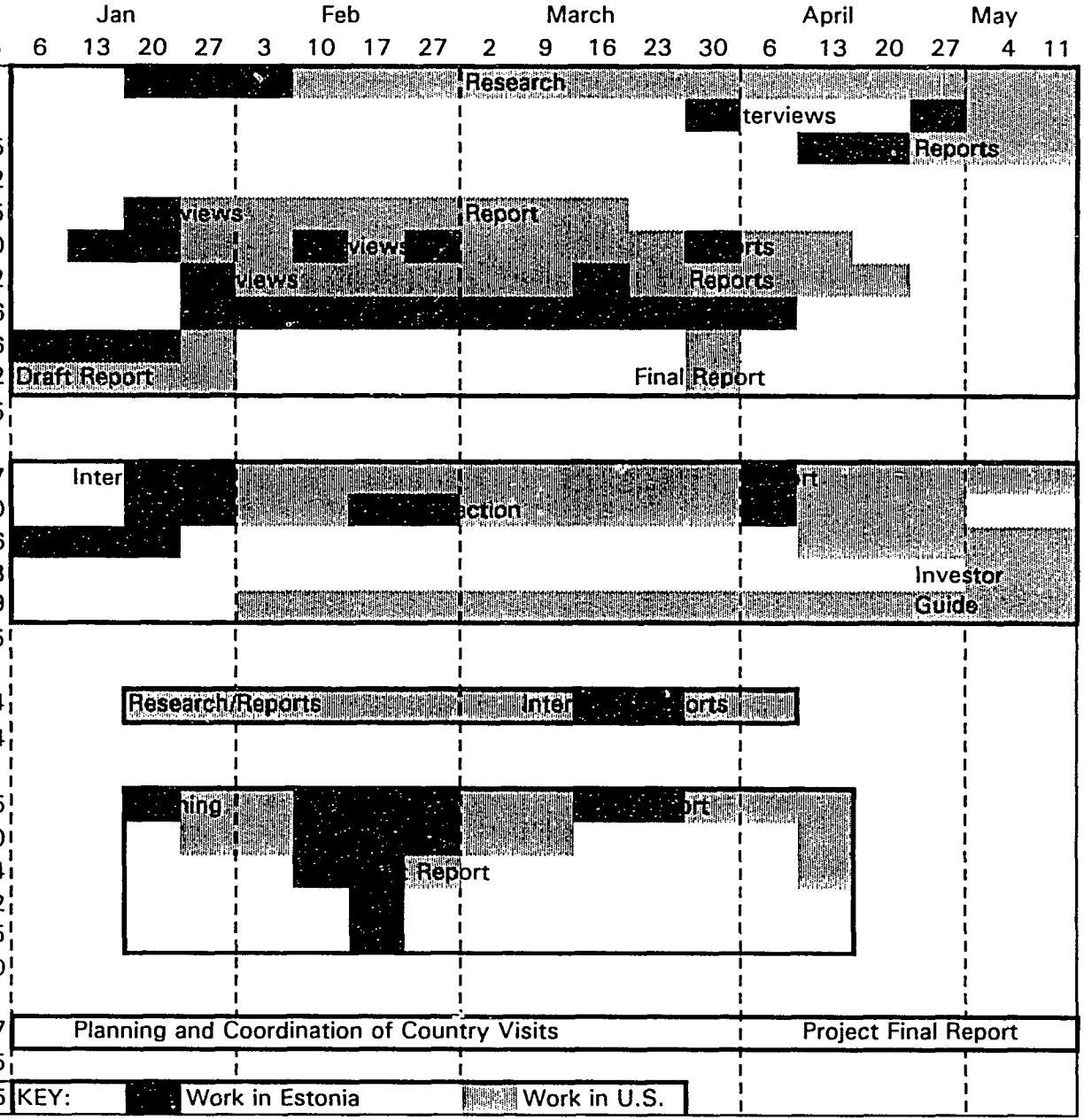

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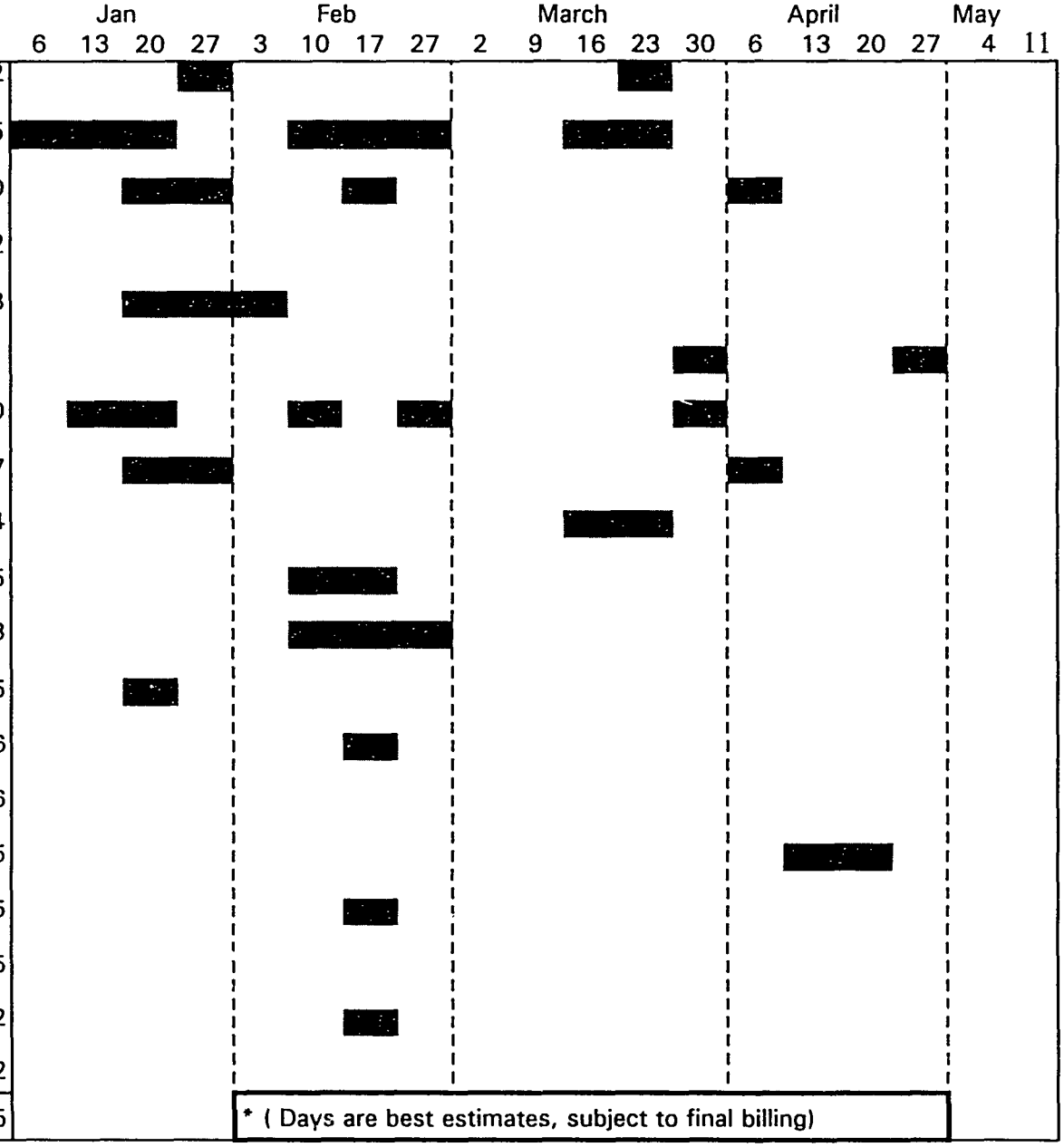
EXHIBIT 3

Phase II Project Team Visits to Estonia - Revised 5/15/92

STAFF	DAYS IN ESTONIA	DAYS IN U.S.	TOTAL DAYS*
Claudon	17	5	22
Wolfe	48	22.5	70.5
Hogan	30	10	40
Marcuss		2	2
Ryder	13	10	23
Bernard	6	5	11
Radon*	22	8	30
Brown	20	7	27
Sunley	11	3	14
Buyske	11	4	15
Nisenson	18	5	23
Weiss	6	4.5	10.5
Warman	6		6
Raig	6		6
Von Mehren	9	16	25
Vickland	2.5		2.5
Folino		25	25
Dean	2		2
Angell		2	2
TOTAL	227.5	129.0	356.5



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In Association with:

Milbank, Tweed, Hadley & McCloy

Legislative Assistance

Submitted to:

Estonian Parliment

Ministry of Justice

Republic of Estonia

Contract # EUR-0014-I-00-1056-00
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Draft

May 15, 1992

LEGISLATIVE ASSISTANCE TO THE GOVERNMENT OF ESTONIA

EXECUTIVE SUMMARY

This report describes how Milbank, Tweed, Hadley & McCloy proceeded in providing legislative assistance to the Government of Estonia and sets forth three recommendations relating to the development of the legal infrastructure necessary to support a market economy in Estonia: (1) the need to systematize the collection and dissemination of Estonian law, (2) the areas where legislation may be necessary and (3) the need to establish a process for developing appropriate legislative proposals.[1/]

This report is organized into five sections. Section I provides an overview of the approach we took to providing legislative assistance and sets forth the task facing Estonia as it develops a legal system governed by the rule of law.

Section II summarizes our findings regarding the current state of Estonian statutory law as it relates to a functioning market economy. The principal objective of this assistance was to identify and compile available statutory law relevant to market economy activity. In the course of so doing, it became clear that there is an urgent need to organize existing law in a way that makes it possible to determine what law is, in fact, in force. Mechanisms to disseminate to legislators, government officials and members of the public comprehensive information about existing and proposed legislation and regulations represent a further urgent need.

Section III sets out areas where we believe gaps exist in the present statutory framework from the standpoint of what is required for a functioning market economy. We also discuss generally our thoughts as to the priority for filling these gaps.

Our analysis of the gaps in Estonia's legal framework is divided into three categories: (1) The Legal Prerequisites for Establishing a Free Market Economy; (2) Privatization and Governmental Economic Activity; and (3) Fundamental State Functions. Our major emphasis was on identifying priorities within the first category. In Section III, we also identify legislation in the two other categories that might be considered and discuss

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1/ Milbank Tweed is part of a consortium headed by Deloitte & Touche, which was awarded a general contract by the United States Agency for International Development to provide emerging democracies in Eastern Europe with technical advice on privatization. Pursuant to the general contract, the consortium was awarded a contract to provide legislative assistance to the Government of Estonia. Fifty-nine days were allocated to Milbank Tweed for Phase II of this contract, EUR-0014-I-00-1056-00.

generally the importance of such legislation in an overall legal framework for a market economy.

Section IV sets out the model legislative assistance process that we initiated in Estonia and describes how the model is operating in the area of securities regulation.

In Section V, we summarize our recommendations.

SECTION I: THE APPROACH

In order to show how the three areas in which we concentrated fit into Estonia's need for a free market legal structure, it is worth briefly outlining the task that Estonia faces in addressing that need. In a capitalist legal system, the rule of law prevails; in a socialist legal system, statist notions of law predominate. In the former system, law is constrained by a constitution, procedures and precedent, while in the latter, law responds to the exigencies of the state.

As the post-Communist countries privatize their economies, their legal systems must undergo a profound transition in the role they play. A legal system in which economic law functions primarily as a means by which the state directs economic activity must give way to a system in which economic law creates a level playing field of competition among individual economic actors and protects the community interests that individual economic activity may ignore.

A legal system governed by the rule of law and that supplies the rules of the game promotes private sector activity by (1) creating a predictable and fair legal environment, (2) protecting and enforcing private agreements and (3) making possible the creation of devices, such as stocks and bonds, that help rationalize the distribution and allocation of investment resources. A system having such characteristics promotes investment of labor and capital in the economy.

The recommendations described in this report would assist in the creation of this kind of legal system by making law generally more accessible and understandable to legislators, government officials and the general populace, by identifying the areas of economic law where new legislation is necessary and by establishing a legislative development process that has a reasonable chance of yielding laws that will play their intended roles.

The transition from a communist to a free market economic system in Estonia may be lengthy. The advanced legal culture that Estonia enjoyed prior to the Soviet occupation has been almost completely destroyed. Its re-creation and adaptation to the modern environment will require wholesale changes in the attitudes and habits that were inculcated in the ensuing five decades.

In some senses, the enactment and promulgation of the necessary legal framework for a private market economy is the easiest part of the task. Making the system work over the long haul will be much harder. Our recommendations are directed towards putting the essential building blocks in place. Maintaining the structure once built, and modifying and adapting it to changing circumstances and perspectives are among the formidable tasks to follow.

SECTION II: COLLECTION, DISSEMINATION AND ORGANIZATION OF ESTONIAN LAW

A. The Collection of Existing Law

Our first effort addressed the need to establish systems for (1) disseminating in a timely and comprehensive fashion information regarding proposed and enacted legislation and proposed and promulgated regulations and (2) researching legislation and regulations in order to aid the legislative process and compliance with the law. At the beginning of this project, we set out to collect and compile existing materials on Estonian statutory enactments so that we could identify gaps in the current legislative framework. Although various organizations had produced collections of Estonian law on an ad hoc basis, no comprehensive collection of Estonian economic law existed either in Estonian or English. As a result, we began the process of (1) identifying statutory law relating to economic activity in a market economy and (2) collecting such of these laws as had been translated into English.

This process involved conversations with and interviews of Estonian authorities for purposes of identifying legislation, decrees and orders relating to private economic activity. From this process emerged a list of laws, decrees and orders, which we ordered chronologically by date of adoption and classified under a number of appropriate legal categories. We assembled a compendium of such English translations of these laws, decrees and orders as were available and indexed them according to the chronological list. We also included certain Russian translations and prepared brief synopses of some of the documents available only in Russian.

Annex A contains the fruits of this effort, which we hope will prove useful to those interested in understanding Estonian law and will serve as a starting point for continuing to organize Estonian laws in the future. We believe that this is the only collection of its sort.

B. Current Sources of Information About Existing Law

In the course of our collection efforts, we discovered that there are two places where the Government of Estonia collects statutes and decrees. The first is in the Department of Systematization of the Ministry of Justice. That department maintains a library that contains copies of all statutes and decrees, organized in volumes by year of enactment.[2] Statutory amendments are included only in the volume of laws for the year in which the amendment was enacted. The staff at the library makes a notation of the amendment in the margin of the original enactment.

Two offices at the Estonian Parliament also collect laws and decrees: the Protocol Office for Laws and the Protocol Office for Decrees. The Protocol Offices seem to contain all Estonian laws and decrees and are organized in a similar way to the Ministry of Justice's Department of Systematization.

When requested, laws were found quickly and efficiently, although one had to know the year and the number of the law to access it. The Department of Systematization is now computerizing, which should increase further the library's efficiency.[3]

As helpful as these depositories are, they need to be improved if they are to serve as a source of up-to-date information about Estonian law. The present system is cumbersome: discovering what the current law is poses difficulties because the laws are organized sequentially, instead of by subject matter, and the system for updating acts when they are amended poses difficulties because no effort is made to interlineate the amendments and the original legislation. Moreover, there is no system at all for discovering the status of proposed legislation, although, once enacted, laws and most decrees are published in the Riigi Teataja and, less comprehensively, in newspapers.

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[2] We delivered a copy of Annex A to the Ministry of Justice, Department of Systematization during one of our stays in-country.

[3] A worthwhile project might be to have the U.S. Library of Congress, another U.S. government institution or a private organization provide technical assistance to the Department of Systematization in organizing and computerizing its library collection.

Our difficulty in collecting Estonian legislation and in identifying legislative proposals led us to conclude that there is a need to develop systems that provide contemporaneous information regarding pending legislation, decrees and orders. Systems must also be developed for organizing and facilitating access to existing law. Laws, decrees and orders should be organized by subject matter and amendments thereto should be incorporated, as appropriate, into the text of existing materials. A subject matter index, possibly accessible by computer, is also warranted.[4/] The goal should be a system that ensures that interested persons can more easily find the area of the law in which they are interested and have confidence that what they have found is complete.[5/]

Over the years, the United States has developed highly efficient systems for accomplishing similar tasks. Aspects of the U.S. systems are described in subsections C and D below.

4/ Creation of such an index would require that staff be trained in legal classification and in creating a subject matter index on a computer so that one could find statutes, decrees, regulations and amendments pertaining to, for example, corporations. For an example of how one might group Estonian laws, see the subject matter classification in Annex E and the discussion below in Subsection D.

5/ The Estonian Government, the U.S. Department of Commerce and the U.S. Embassy in Tallinn might consider the creation of a system to translate Estonian legislation and regulations into English on a periodic basis. Such a system would help increase U.S. investment in Estonia. We have discussed this possibility with Pamela Green, Desk Officer for Latvia, Lithuania and Estonia, U.S. Department of Commerce, Linda Wells, Director, Commercial Law Development Program for Central and Eastern Europe, U.S. Department of Commerce, Susan Gurley, Deputy Director, Commercial Law Development Program for Central and Eastern Europe, U.S. Department of Commerce, Daniel Haendel, Senior Counsel, Office of General Counsel, U.S. Department of Commerce, Brad Fujimoto, Country Director for Estonia, U.S. Agency for International Development and Ingrid Kollist, Economics Officer, U.S. Embassy Tallinn, U.S. Department of State. Each of these individuals seemed to agree on the value of such a system.

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C. The Dissemination of Laws, Decrees and Regulations

The United States has a comprehensive system for addressing the needs of the public for information on existing and proposed legislation, Congressional debates, legislative enactments and proposed and final regulations. By law, all public proceedings of Congress[6] and all executive orders and regulations promulgated by the Executive Branch and independent agencies that have general applicability and legal effect are required to be published.[7] The Congressional Record is published by the Government Printing Office ("GPO") under the direction of the House and Senate Joint Committee on Printing. The GPO publishes the Congressional Record for each day Congress is in session.[8] It contains all House and Senate floor speeches, debates, amendments to bills and administrative comments (e.g., letters of resignation, committee assignments). The Congressional Record provides the public with a permanent record of bills introduced, reports filed by congressional committees, communications received from the executive branch and the states, and tallies of how members voted on bills and resolutions.

The GPO also prints the Federal Register daily.[9] It contains executive orders issued by the President, regulations promulgated by the Executive Branch and notices of public meetings by government agencies. Its importance cannot be underestimated. In addition to publishing the actual text of an agency regulation, the Federal Register provides the public with a synopsis of the regulation, an indication of the statute on which it is based, the purpose of the proposed regulation and a general explanation of the object to be achieved. Regulations generally are published first as proposals. The public is then given time to submit comments on the regulation and make suggestions. Such comments usually are submitted by legal or other professionals in a given field and are considered by the agency staff as it completes the final draft of a regulation.

Both the Congressional Record and the Federal Register are available by subscription or from GPO bookstores located throughout the United States. In addition, the

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6/ 44 U.S.C. § 901 (1988).

7/ 5 U.S.C. § 552 (1988). The Administrative Procedure Act, 5 U.S.C. § 551 et seq. (1988), establishes the basic procedural framework within which administrative agencies must operate and promulgate regulations.

8/ We have attached a recent copy of the Congressional Record as Annex B.

9/ We have attached a recent copy of the Federal Register as Annex C.

GPO deposits copies of both publications at designated college and university libraries throughout the country.

Another source of information on laws and regulations is the United States Code Congressional and Administrative News, which contains all public laws passed during a session of Congress and some committee reports on legislation. Committee reports, as part of the legislative history of a particular piece of legislation, are used by lawyers as a way of understanding the legislature's purpose and intent.

D. Codification of Statutes and Regulations

(i) Statutes

Codification is a term that refers to the process of collecting and arranging systematically, usually by subject, the laws or regulations of a state relating to a particular subject of legislation. The system in the United States for codifying statutory enactments is as follows: a copy of every bill that becomes law is given to the Archivist of the United States.[10] The Archivist makes copies thereof, known as "slip laws," available to the public. The Archivist is also responsible for compiling, editing, indexing and publishing the Statutes at Large of the United States. The Statutes at Large contain all the laws enacted during a session of Congress in a sequential order, similar to the annual volumes now created by the Estonian government.

The Law Revision Counsel, an office of the United States House of Representatives,[11] is responsible for placing new laws in their proper place in the United States Code ("the Code").[12] The Law Revision Counsel periodically publishes an updated version of the Code.[13] In addition, private firms publish an annotated version of the Code

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[10] 1 U.S.C. § 106 (1988).

[11] 2 U.S.C. § 285 (1988).

[12] The Code is the compilation of all enacted laws of the United States. It has 50 titles, which are organized by subject matter, e.g., Title 12 includes laws on "Banks and Banking."

[13] Currently, the Counsel publishes a new version of the Code every five years.

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with annual supplements that reflect congressional action.[14] These efforts are indispensable to the legal community in the United States because codification simplifies the identification of what laws are relevant to a particular legal question and makes it possible to find with relative ease the current state of the law on a given subject.

(ii) Regulation

The Office of the Federal Register, which is under the jurisdiction of the Archivist, is responsible for compiling the regulations promulgated by U.S. Federal departments and agencies. The regulations are periodically codified and printed in the Code of Federal Regulations ("CFR").[15] Like the Code, the CFR is organized by subject matter in 50 titles.[16] All CFR titles must be reprinted annually on a rotating basis.[17] Just as for the Code, the CFR helps lawyers in determining what the current regulations are for a specific subject area.

Besides these official efforts to codify legislation and regulations, private companies in the United States provide additional services helpful to lawyers in researching legal issues. These services include Lexis and Westlaw, which are companies that provide on-line files accessible by modem that contain court cases, laws, regulations and news reports.

SECTION III: GAPS IN THE LEGISLATIVE FRAMEWORK

On the basis of our compilation of existing Estonian legislation, as described above in Section II, we sought to identify the gaps in the existing legislative framework for a private market economy. To do so, we organized Estonian economic legislation, orders and decrees on the basis of their subject matter and compared the subjects covered with those

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[14] An annotated code includes remarks, case law applying the particular legislation and notes on when the legislation was enacted and, if applicable, amended.

[15] 44 U.S.C. § 1510 (1988).

[16] In many instances, the Code and CFR titles are parallel, e.g., Title 12 of the CFR is also "Banks and Banking".

[17] For instance, Title 7 (agriculture) is reprinted every January 1; Title 49 (transportation) is reprinted every October 1.

typically covered in advanced or rapidly evolving market economies. We discussed the gaps that appeared to exist on the basis of such comparisons with Estonian officials in ministries and other agencies active in privatization and the transition to a market economy in Estonia, who were asked their views on what legislative or regulatory initiatives they believed were most needed.[18]

Our assessment of where gaps exist in the present legislative framework is organized into three broad categories: (A) Legal Prerequisites for Establishing a Free Market Economy; (B) Privatization and Governmental Economic Activity; and (C) Fundamental State Functions. The first category includes the basic laws necessary to create a market economy. We have further divided this category into four different subcategories, reflecting our views as to the approximate priority of each subcategory as follows: (i) the Constitution, (ii) Core Free Market Legislation, (iii) a Judicial and Administrative System and (iv) the Regulation of Private Economic Activity. Although we have not included in these categories legislation that has already been enacted, such as the property and banking laws, we recommend that these statutes be reviewed by applying the process that we discuss below in Section V.

The second broad category is comprised of laws relating to privatization and governmental economic action. We note that legislation on privatization may not be fully effective in the absence of a constitution and enactment of legislation relating to the matters identified in the Core Free Market Legislation subcategory. A basic legal context is essential to the stability and certainty regarding property and contract rights that is central to the existence of a favorable investment climate. We have included legislation relating to governmental economic action in this category because part of the privatization process will involve determining the sectors in which the government will remain the primary economic actor.

The third category includes legislation relating to fundamental state functions, such as the maintenance of a social safety net. Although most of the legislation in this category is fundamental to creating a nation state, this legislation does not directly relate to our task of identifying gaps in the present legislative framework for a private market economy. We include this list in recognition of the fact that the Estonian Government must inescapably address matters of this nature as it moves forward.

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[18] Annex D provides a list of Estonian government officials and members of the private sector who were seen by us in connection with our legislative assistance. Annex E presents a list of existing Estonian legislation organized by subject matter, combined with the topics where further legislation or regulation is recommended.

A. Legal Prerequisites for Establishing a Market Economy

We recommend that the Estonian Government concentrate on the passage of legislation in this category, with the highest priority for legislation in the first two subcategories below. Legislation in all of these subcategories constitutes a basic building block in the legal regime of a private market economy.

(i) The Constitution

Although we have not been asked to advise the Estonian Constitutional Assembly with respect to the creation of an Estonian constitution, that effort is, of course, crucial to our field of activity. A constitution appropriate to the functioning of a private market economy would embody fundamental, over-arching concepts of economic freedom and property rights. It would deal with such matters as due process, equal protection, abridgement of contract, ex post facto laws, state takings and other matters that establish the basic ground rules of economic and social organization. It would also presumably deal with the relationship among the constituent parts of the governmental apparatus, including the procedure for enactment and amendment of statutory and constitutional law.

(ii) Core Free Market Legislation

The second subcategory of legislation relates to the detailed, practical aspects of day-to-day commercial life. Several other subjects, such as property, would have been included on this list if Estonia had not enacted legislation covering those subjects. To the best of our knowledge, Estonia has not yet enacted legislation on each of the subjects listed below.

Commercial Code/Contracts

The establishment of basic norms of contract and sales law is essential to the effective functioning of the commercial order. Economic efficiency is furthered by the adoption of basic precepts regarding the formation, performance and enforcement of contracts and the terms implied in the sale of goods.

Restitution

Legislation relating to restitution of property nationalized by the state is an important step in creating a free market system. The ability to grant clear title is essential to legal certainty. This can, of course, be accomplished either through the rapid cut-off and processing of claims or the policy decision to provide compensation rather than restitution.

Security Interests in Personal and Real Property

The provision of debt financing relies heavily upon lenders' ability to take or retain security interests in assets held by the debtor. The importance of secured lending is even greater in situations where the credit of the borrower is not well-established, as is likely to be the case in much of the privatized Estonian economy. Laws in this area must be integrated with the existing property law and any bankruptcy law that is adopted, for property law and security interests are intimately related, and it is often in bankruptcy proceedings that security interests are enforced.

Bankruptcy

Central to the efficient allocation of resources is the market's mechanism for determining and resolving their misallocation. The bankruptcy system is pivotal in effecting a reallocation of assets and enforcing notions of limited liability in the event of failed enterprises. New and newly-privatized enterprises will be tested in the market and, if uncompetitive, must be restructured or liquidated. An effective bankruptcy system is also central to encouraging fresh investment, for creditors will not provide debt financing without a fair mechanism for apportioning assets in the event of failed enterprises.

This is a highly technical area that relies heavily upon the interactions of the general obligations, property, mortgage and security interest laws, the companies law and the securities laws. It must be integrated with those laws and should perhaps be enacted in a package with them.

Intellectual Property

An increasing proportion of the global economy involves the provision of goods and services protected by, or produced by means protected by,

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intellectual property rights. Mechanisms must be provided for the recognition of the rights of intellectual property developed both in other countries and in Estonia. Certain aspects of this protection might be accomplished by accession to appropriate international conventions. Areas for protection include copyright, trademark, patent and industrial design, and trade secrets.

(iii) A Judicial and Administrative System

The creation of systems for settling economic disputes or regulating economic behavior is crucial to enforcing the rights created by core free market laws and establishing procedures by which the government can regulate economic behavior.

Among the subjects for legislation in this subcategory are the following:

Establishment of Bankruptcy Courts and Procedures

As noted above, the bankruptcy system will have a very significant role in the transition to and operation of the market economy. In some respects, it will be as much involved in the privatization process as the government itself and will perhaps have a greater administrative role in the reallocation of assets. An effective bankruptcy system requires clear procedures and adequate resources to provide quick and effective adjudication.

Code of Civil Procedure; Establishment of Commercial Courts

Important to the development of the private economy will be providing means for the resolution of private commercial disputes. Speed and clarity of result are important elements in ensuring legal certainty. The establishment of an independent commercial court may be a means of quickly securing the necessary expertise and resources for effective commercial dispute resolution. Some objectives can be accomplished by way of adherence to international conventions.

Arbitration Law and Procedures

Provisions for alternative (non-judicial) dispute resolution procedures are a common feature of many commercial relationships. This is especially so in both domestic and foreign investment contexts where the local commercial judicial system is not well established or in the international context where

neither party is willing to submit to adjudication in the other's home jurisdiction. Legislation providing support for these procedures (e.g., judicial enforcement of arbitral awards) is an important part of such a system.

Administrative Procedures Act

Laws to govern the process whereby executive agencies implement statutory enactments through the promulgation of regulations and the making of administrative determinations can be an important adjunct to economic regulation. A common feature is a right of appeal to the courts if regulations do not properly reflect the underlying laws or if administrative adjudications are not properly made.

Ethics in Government

Members of all branches of government must be bound by a series of norms ensuring that the public trust is not violated. Typical provisions require abstention from matters where officials have a personal interest and mechanisms for the disclosure of financial interests and conflicts.

Government Procurement

Government procurement must be carried out in the public interest and without favoritism. Typically this is accomplished with public bidding and tender mechanisms and transparent administrative procedures.

Collection, Dissemination and Codification of Laws and Regulations

The Estonian Government should create a system to collect, disseminate and codify its laws and regulations, for the reasons discussed in Section II.

(iv) **The Regulation of Private Economic Activity**

The unfettered functioning of the marketplace may produce social or economic consequences that the legislature may seek to mitigate in accordance with its own notions of social and economic policy. By the same token, unregulated private economic activity may occasionally prove antithetical to an efficiently functioning marketplace. The effective dissemination of financial information and the prevention of anticompetitive behavior, for

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example, are important to efficient capital accumulation and formation. Legislation in the following areas would address some of these issues:

Competition

Competition laws regulate unfair market practices (e.g., price-fixing) among competitors and monopoly or quasi-monopoly situations that impair or preclude effective competition. Since new enterprises emerging from privatized state-owned enterprises are likely to be among the most significant contributors to Estonia's economic growth and development in the near term, competition law takes on great importance in preventing the old order from undermining the emergence of the new order. This topic is the most important in this category.

Securities

The redeployment of capital assets and the recapitalization of the economy are accomplished in large part through the issuance and transfer of securities. An efficient and well-regulated securities market is a prerequisite to the mobilization of capital. A securities law is also an absolute prerequisite for any mass privatization voucher scheme.

Insurance

The pooling, spreading and management of risk through insurance is an important component of efficient price setting in the market economy. Investment is facilitated by the availability of protection against certain risks. From a regulatory perspective, insurance intermediaries, like other financial institutions, must be held to standards of public accountability, typically through basic regulation of their activities and regular reporting requirements.

Investment Trusts/Mutual Funds

To the extent that privatization is to give the citizenry a stake in the economy, an effective mechanism must be provided for pooling smaller investors' capital. Intermediaries such as investment trusts and mutual funds provide vehicles for such capital accumulation and also permit highly dispersed capital (such as that created by a voucher scheme or by small pensions) to play a role in corporate management.

B. Privatization and Governmental Economic Activity

This second category of legislation relates to the process by which state assets or their management are transferred to the private sector and the extent to which the Estonian government will continue to be involved in the management of state assets hereafter.

Legislation in this category is fundamentally different from legislation included under the Legal Prerequisites for Establishing a Free Market Economy category and is a function of complex political, social and economic choices relating to the ultimate shape of the Estonian economy. The laws we have identified in the subcategory entitled Core Free Market Legislation, as well as certain of the laws in the category the Regulation of Private Economic Activity, such as securities and investment fund laws, should be enacted prior to legislation on privatization. We have not included in this category legislation relating to a voucher system, medium-scale privatization and large-scale privatization because the Estonian Government understands well the importance of these legislative initiatives.

Law on Sectors and Enterprises Reserved from Privatization

The promulgation of privatization procedures for enterprises of a given scale should be accompanied by the identification of any sectors or enterprises reserved from privatization.

A danger exists that during the process of privatization existing ministries with responsibility for managing the state sector will be destroyed. Such an eventuality could lead to a situation in which neither private investors want to take over the enterprise nor government officials will have the skills to manage the enterprise.

Law on Concessions and the Exploitation of Natural Resources on State-Owned Land

The grant of concessions for the exploitation of natural resources on state-owned land or for the provision of services formerly delivered by the state (e.g., transportation) should be conducted in a judicious and transparent fashion. The transfer of services to the private sector and the encouragement of procurement from private industry can constitute a large component of privatization. The use of concession contracts is often more advantageous than

immediately creating a complex regulatory and administrative framework to regulate private investment in natural resources.

C. Fundamental State Functions

The legislation contained in this category relates to basic functions of the state. Such legislation is important principally from perspectives other than creating a legal framework for a market economy. The list here is far from exhaustive; it concentrates on those state functions that are most directly implicated by the privatization process.

Currency Reform

The efficient allocation of productive resources is virtually impossible without a reliable medium of exchange. Currency reform will also serve the political objective of nation-building by creating a national currency.

Social Welfare

The importance of providing basic social support and protection during the transition to the market economy cannot be underestimated. While not strictly part of the privatization agenda, action may be appropriate in the areas of:

1. income support and retraining;
2. labor law; and
3. independent trade union law.

Environmental Protection Law

The externalities of environmental degradation constitute a real cost to the private economy that often can be addressed only through government regulation or incentive programs. The adoption of a plan for the gradual introduction of common norms (perhaps those of the European Community) would provide the market with legal certainty and improve the investment climate.

Consumer Protection

Measures protecting the individual consumer from fraudulent or oppressive sales tactics, personal injury or property damage and defective goods are often

gathered together in a consumer protection law, especially if the remedies in the sales and civil responsibility laws are inadequate.

Program for Harmonization of Laws and Regulations with European Community Norms

A program for the harmonization of laws and regulations with European Community ("EC") norms, while not strictly part of the legislative agenda for a market economy, would be of value in establishing the direction of the country in future economic legislation and providing greater legal certainty to domestic, European and other investors. Each legislative initiative should at least be informed by the relevant EC norms, which might provide a useful point of departure.

Significant areas for harmonization might include:

1. technical norms and standards;
2. public procurement;
3. consumer protection;
4. financial services regulation;
5. environmental regulation;
6. competition law;
7. telecommunications;
8. intellectual property; and
9. professional qualifications.

SECTION IV: A PROCESS FOR DEVELOPING FREE MARKET LAWS

Section III of this report identifies subjects requiring legislative or regulatory attention. This Section suggests a mechanism for developing requisite legislation in each area.

We recognized from the outset that, in trying to provide technical legal assistance, there is a risk that such assistance would be infused by perspectives that are suitable only for different social and political settings. The development of law suitable to a given environment involves much more than simple transplantation. Laws relating to economic activity in the West are the product of years of effort to find practical solutions to

problems in response to the pull and tug of different social and economic constituencies. The institutional support necessary for the rule of law -- the development of a legal profession and systems for dispute resolution and enforcement -- also developed gradually along with the accumulation and refinement of such laws.

Countries like Estonia are attempting to run the process in reverse. Parliaments are borrowing mature legal concepts from foreign societies and enacting them as part of their own body of laws long before relevant constituencies have come into existence. Moreover, neither the legal professions nor the judicial systems in these countries are equipped to implement the laws being enacted.

In recognition of these realities, the Soviet/American Securities Law Working Group ("SASLAW") -- which we serve as chairman -- developed and implemented a model for introducing Western securities law concepts to post-Communist countries.[19] We believe that the model works for other areas of economic regulation and have sought to adapt the model to Estonian circumstances through discussions with government and private sector officials in Estonia. In consultation with these officials, we also applied the model in Estonia in the area of securities law.

A. The Process

The SASLAW process consists of six basic steps:

(i) Organization of a working group from representatives of relevant governmental ministries and agencies and the private sector.

(ii) Identification of Western legal experts to advise the working group.

(iii) Creation by the Western legal experts and the working group of a concept outline describing how the best Western practices in the particular field of law might be adapted to local circumstances.

(iv) Conduct of an educational seminar designed to (1) synthesize the theoretical and practical experience of the working group with the

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[19] Annex F describes SASLAW and its work.

theory and practices developed in the West and (2) discuss the legal approaches embodied in the concept outline with the working group.

(v) Review of relevant existing laws and drafting by the working group of the planned legislation.

(vi) Review of the draft legislation by the Western legal experts for purposes of identifying major problems.

These six basic steps will bring each project through the legislative drafting process and, therefore, through the areas in which Western legal experts can have the most impact. Western legal experts can be of continuing assistance in at least two ways as the legislation moves through the ministries and legislative bodies. First, they can help the legislation's sponsors articulate the rationale for the legislation in general and with respect to particular provisions. Second, when changes are necessary, they can assist in assuring that changes are made in such a way that a coherent law emerges. In the case of economic regulation (such as a securities law), continuing legal technical assistance through periodic visits can be helpful in crafting implementing rules and forms, training the professional staff of the regulatory authority and educating the public.

Estonia should also address the question of coordinating the multiple law projects that our recommended approach anticipates. One possibility would be to appoint a small supervisory group -- perhaps drawn from the Ministries of Justice and Economics -- to coordinate the various working groups and serve as an information clearing house. The coordinating group could help identify appropriate members of each legal area's working group and locate the requisite Western legal expertise. A key function of the coordinating group would be to assure that the legislation emerging from different working groups forms a cohesive legal system that is neither overlapping, contradictory, nor inconsistent. Because inconsistencies among proposed laws may not always be obvious, provision for a Western legal expert to assist in this coordinating role would also be helpful.

B. The Pilot Program in Estonia

(i) Working Group

In developing an Estonian securities proposal, the working group was created in a quite formal way: Governmental Decree No. 6, the "Temporary Constituting Document of the Estonian Exchange Council" (January 6, 1992), created a council consisting of representatives from various Ministries, Eesti Bank and the private sector. The inclusion of

private sector representatives was especially useful, since private sector support is absolutely vital to building a supportive constituency.

(ii) Western Legal Experts

Although the AID contract provided the vehicle for bringing our expertise to bear on the Estonian securities law, our initial contacts with the embryonic Estonian securities industry predated the contract. During 1991, Estonian private sector and government officials attended several seminars on securities regulation and disclosure and on stock exchange and brokerage operations that we organized in Moscow, St. Petersburg and Minsk. We also discussed questions of securities regulation with officials from the Estonian Ministry of Finance, Eesti Bank and various exchanges during February, 1992. Such discussion set the stage for the April seminar discussed below.

(iii) Concept Outline

In this instance, we were able to make use of the concept outline prepared by SASLAW in 1990.[20] The SASLAW members that developed the outline included not only American securities law experts, but also lawyers and an economist from the then-USSR.

(iv) Educational Seminar

Working with private sector representatives, we organized and conducted a four-day seminar on securities regulation and disclosure and on stock exchange and brokerage operations in Tallinn on April 27-30.[21] Sixteen people attended from Estonia, including several representatives from the ministries and other organizations making up the Estonian Exchange Council. Seven private sector representatives from Latvia and Lithuania were also present.[22]

Of significance from the standpoint of building a constituency for securities regulation within the emerging Estonian securities industry, the seminar class consisted predominantly of private sector representatives. This means that present and future leaders of the Estonian securities industry heard, and we hope embraced, our arguments based on

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[20] Annex G.

[21] See Annex H.

[22] See Annex I.

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Western experience, that the security industry's long-term interests lie in the creation of fair and orderly markets under the umbrella of an effective regulatory scheme.

(v) Drafting

The Estonian Exchange Council has appointed a special subcommittee to draft the Estonian securities law. We have supplied the subcommittee with various source materials. They include the recently-passed Byelorussian securities law, which derives in many respects form the concept outline. The subcommittee is currently drafting the law.

(vi) Review by Western Legal Experts

We are scheduled to meet members of the drafting subcommittee in Moscow on May 16, 1992, to review the draft law.

SECTION V: SUMMARY OF RECOMMENDATIONS

This report sets forth three basic recommendations with respect to the creation of a legal infrastructure that is conducive to a private to a market economy in Estonia. The first relates to methods for improving the capacity for identifying the existing body of statutory law and disseminating its provisions to government officials, legislators and members of the public both at home and abroad. The second relates to the need for further statutory development in specified areas for the purposes of filling in gaps in the current statutory framework. The third relates to the establishment of a process for developing appropriate legislative proposals to deal with specified areas of economic activity.

With regard to improving Estonia's ability to identify and disseminate information about existing statutory law, we recommend that the Department of Systematization of the Ministry of Justice and the Parliamentary Protocol Offices be strengthened by establishing systems to collect and codify legislation and regulation. We also recommend that the types of information contained in the Riigi Teataja, a government publication, be broadened to include information about parliamentary proceedings, current parliamentary agendas, matters being developed for parliamentary consideration, regulations and orders being considered by governmental ministries and regulations and orders actually issued by governmental ministries. We also noted ways in which information about Estonian statutory law might be made available on a systematic basis to foreign embassies, foreign investors and the general public. Finally, we recommend the creation of a system for

organizing Estonian statutory law that would make it possible to identify all statutory enactments and amendments relating to specified subject areas.

With respect to the need for further statutory development, we have identified a number of gaps in the existing statutory framework that need to be filled for purposes of creating a legal regime that deals with the subjects most frequently addressed in efficiently functioning private market economies. The most important areas for immediate consideration relate to contracts, property, secured interests in real and personal property, commercial transactions, corporations, bankruptcy, banking, accounting, competition and capital markets. The creation of a judicial system to protect and enforce private property rights and to ensure due process is also a matter of high priority.

With respect to the development of appropriate legislative proposals, we recommend the adoption of a process of interchange between Western legal experts and governmental and private sector representatives from Estonia, so that each can profit from mutual education and collaborate drafting. This model has worked well in several other former Soviet republics in the development of securities legislation, and we demonstrated its applicability to Estonia in a pilot project that is expected to produce draft securities legislation by the end of May that may be appropriate for parliamentary consideration.

ANNEXES

Compendium of Estonian Legal Documents . . . . . A

Sample Edition of Congressional Record . . . . . B

Sample Edition of Federal Register C

List of Principal Contacts . . . . . D

Subject Classification of Existing and Recommended Legislation . . . . . E

SASLAW Background Materials . . . . . F

Outline of Recommended Securities Law . . . . . G

Topics of General Sessions . . . . . H

List of Participants I

[Annex A is bound separately.]

[Annex B is bound separately.]

[Annex C is bound separately.]

List of Principal Contacts

Set out below are the names and titles of the principal Estonian officials and members of the private sector with whom representatives of Milbank, Tweed met in connection with the legislative assistance provided.

A. **Ministry of Justice**

1. Mart Rask, Minister of Justice
2. Imbi Markus, Deputy Minister of Justice
3. Vahur Glaase, Head of the Department of International Law and Foreign Relations

B. **Ministry of Economics**

1. Ardo Kamratov, Deputy Minister of Economics [also contacted in former capacity of Director General, Board of State Property]
2. Erik Terk [in former capacity of Deputy Minister of Economics]
3. Liina Tonisson [in former capacity of Head of Department of Entrepreneurship]

C. **Supreme Council**

1. Tonu Anton, Chair, Standing Legal Committee
2. Liia Hanni, Member, Standing Legal Committee
3. Ivar Raig, Chairman, Rural Centre Party

D. **Ministry of Finance**

1. Rein Miller, Minister of Finance
2. Antti Vinnal, Deputy Minister of Finance

E. **Ministry of Foreign Affairs**

1. Priit Kolbre, Head of Foreign Economic Policy Department
2. Hillar A. Lauri, Counselor

F. **Department of Foreign Economic Relations**

1. Mehis Pilv, Director-General

G. **Board of State Property**

1. Riho Rasmann, Director-General
2. Viktor Fjodorov, Section Chief, Leasing Department

H. **Bank of Estonia**

1. Vahur Kraft, Vice President
2. Einu Reitsnik, Director of Currency Department

I. **Estonian Savings Bank**

1. Ruslan Dontsav, Chairman of the Board
2. Tatjana Muravjova, Vice-Chairman of the Board

J. **Ministry of Industry**

1. Aksel Treimann, Minister of Industry [in former capacity as head of agricultural trade organization]

K. **Constitutional Assembly**

1. Juri Adams, Member

L. **Estonian Attorney's Association**

1. Indrek Teder, Vice Chairman

M. **Estonian Chamber of Commerce**

1. Peeter Tammoja, President

N. **Institute for Economic Development**

1. Ants Kulo, Director

O. **Exchange Association of Estonia**

1. Aivo Reiner, General Secretary

P. **Tallinn International Stock Exchange**

1. Juri Tarmak, Vice Chairman

Q. **Broker Baltic, Ltd.**

1. Nadezhda Tarmak, Director
2. Viktor Mahhov, Broker

R. **Mainor Investment Management**

1. Gunnar Kraft, Director
2. Andrus Virg, Director
3. Harmo Vark, Director

Subject classification of existing and recommended legislation

		Adoption
	Administrative law/National government	
	Budget Law	11/17/89
	Decree on Conditions of Employees' Pay in Budgetary Institutions and Organizations	01/12/90
	Law on State Registers	01/26/90
	Law on Statistics	03/23/90
	Law on State Control	06/06/90
	Decree on the Creation of a Self-Governing Primary Education System	07/17/90
	Statute on Forming the Committee for Drafting Laws	09/03/90
	Decree on the Development of Statistics	05/15/91
	Resolution on the National Independence of Estonia	08/20/91
*	Administrative procedure act	
*	Ethics in government law	
*	Government procurement regulations	
	Agriculture	
	Law on Peasant Farming	12/06/89
	Banking/Currency reform/Finance/Insurance	
	Law on the Foundation of the Estonian Bank	12/22/89
	Bank Law	12/28/89
	Decision Confirming the Statute on the Estonian Bank	03/15/90
	Order Establishing the Foreign Currency Fund	07/02/90
*	Currency reform	
*	Insurance law	
*	Investment trust/mutual fund law	
*	Law on free movement of capital	
*	Securities and exchange law	
	Bankruptcy	
*	Bankruptcy law	
*	Law establishing bankruptcy courts and procedure	
	Commercial law	
	Law on Leasing	09/26/90
*	Draft Law on Collateral	12/30/91
*	Commercial code/Contract law	
*	Consumer protection law	

* Recommended

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Subject classification of existing and recommended legislation

Communications

	Communication Law	01/16/91

Competition law

*	Competition law	

Dispute resolution

*	Arbitration law and procedures	
*	Code of civil procedure; establishment of commercial court	

Economic regulation

	Price Law	12/06/89
	Decree on the State Regulation of the Economy	01/12/90
	Decree on Licensing of Occupations of Enterprises	05/08/90
	Order Regulating Prices and Tariffs	05/28/90
	Law on Operating License Tax	09/25/90
	Decree on the Temporary Freezing of Retail Prices and Tariffs on Services	01/14/91
	Decree on Compensation for the Rise of Prices of Foodstuffs for Inhabitants in the First Quarter of 1991	01/20/91
	Decree on the Temporary Order Regulating Prices and Tariffs	03/27/91
	Decree on Primary Measures for Developing Exchange Activity	07/16/91
	Decree on the Reappraisal of Capital Stock	11/01/91
	Order on the Transfer from Local Control of Enterprises, Associations, Organizations and Institutions	11/13/91
	Temporary Constituting Document of the Estonian Exchange Council	01/06/92
	Temporary Regulation for Regulating Exchange Activity	01/06/92
*	Law on exploitation of natural resources on state-owned land	

Enterprises (including state-owned enterprises)

	Law on Enterprises	11/17/89
	Statute on Joint-Stock Companies	11/23/89
	Law on Peasant Farming	12/06/89
	Statute of People's Enterprise	12/11/89
	Decree on the Order of Registration of Joint Ventures	04/28/90
	Statute on Economic Associations	06/13/90
	Decree on the Foundation of the Estonian State Register of Enterprises, Institutions and Organizations	06/25/90
	Statute on Municipal Enterprises	07/05/90

* Recommended

Subject classification of existing and recommended legislation

Enterprises (including state-owned enterprises)

	Statute on State Enterprises	07/05/90
	Decree on the Decentralization of Entrepreneurship	07/17/90
	Decree on the Transition of State Enterprises to New Organizational Forms	12/29/90
	Statute on the Administration Council of State Enterprises	12/29/90
	Temporary Instruction on the Establishment of State Joint-Stock Companies	12/29/90
	Temporary Statute on the Administration of State Joint-Stock Companies of the First Type	12/29/90
	Temporary Statute on the Administration of State Joint-Stock Companies of the Second Type	12/29/90
*	Non-profit organization law	

Environment

*	Environmental protection law	

European Community law

*	Program for harmonisation of laws and regulations to EC norms	

Foreign trade and investment

	Law on Regulating Export and Import of Goods	01/26/90
	Decree on the Order of Registration of Joint Ventures	04/28/90
	Law on the Economic Border	10/22/90
	Decree on Advantages for Foreign Trade Operations of Enterprises Situated in the Territory of Narva	02/18/91
	Law on Tax Concessions to Enterprises with Foreign Capital	09/10/91
	Decision Implementing the Law on Foreign Investment and the Law on Tax Concessions to Enterprises with Foreign Capital	09/11/91
	Law on Foreign Investment	09/11/91
	Decree on the Liberalization of Foreign Economic Affairs	10/31/91

Immigration

	Immigration Law	06/26/90

Intellectual property

*	Copyright law
*	Law on trade secrets and intellectual property
*	Patent law
*	Trademark law

* Recommended

Subject classification of existing and recommended legislation

Local government

Law on the Fundamentals of Local Self-Government	11/13/89
Budget Law	11/17/89

Ownership/Property reform/Restitution

Decree on Preparation of the Reform of Ownership and Land	03/25/90
Property Law	06/13/90
Decree on the Restoration of Continuity of Ownership Rights	12/19/90
Decree on the Preparation of Property and Land Reform	03/25/91
Decree on Organizational Guarantees in the Realization of Ownership and Land Reform	05/07/91
Law on the Fundamentals of Property Reform	06/13/91
Decree on the Implementation of the Law on the Fundamentals of Property Reform	06/20/91
* Restitution law	

Privatization/State property/Leasing of state property

Decree on Preparation for Transfer of Property of State Enterprises, Institutions and Organizations to Municipal Ownership	12/29/89
Decree on Establishing and Applying the Law on Privatization of State Enterprises of Consumer Service, Trade and Public Catering	12/13/90
Law on Privatization of State Enterprises of Consumer Service, Trade and Public Catering	12/13/90
Decree on the Transition of State Enterprises to New Organizational Forms	12/29/90
Decree on Leasing Relations	01/21/91
Statute on Leased Enterprises	01/21/91
Statute on Leasing Contracts	01/21/91
Form of Agreement on Leasing State Property	03/18/91
Instructions on Agreement and Registration of Agreements on Leasing the Property of a State Enterprise as a Whole	03/18/91
Instructions on Estimates for Leasing State Property	03/18/91
Recommendations on Leasing State Enterprises	04/29/91
Decree on the Privatization of Soviet-controlled State Enterprises, Institutions and Organizations	05/07/91
Decree on the Transfer of Small State Enterprises	06/07/91
Law on the Fundamentals of Property Reform	06/13/91
Decree on the Implementation of the Law on the Fundamentals of Property Reform	06/20/91
Decree on Leasing State Enterprise Property	08/20/91

* Recommended

Subject classification of existing and recommended legislation

	Privatization/State property/Leasing of state property	
	Decree on the Reappraisal of Capital Stock	11/01/91
	Order on the Transfer from Local Control of Enterprises, Associations, Organizations and Institutions	11/13/91
*	Large-scale privatization law	
*	Law on sectors and enterprises reserved from privatization	
*	Medium-scale privatization law	
*	Voucher system	
	Professions	
	Statute on Accountancy	07/31/90
	Real property/Land reform	
	Decree on Preparation of the Reform of Ownership and Land	03/25/90
	Decree on Land Reform	12/20/90
	Decree on the Preparation of Property and Land Reform	03/25/91
	Decree on Organizational Guarantees in the Realization of Ownership and Land Reform	05/07/91
	Decree on the Implementation of the Law on Land Reform	10/17/91
	Law on Land Reform	10/17/91
	Social welfare	
	Law on Health Security	06/12/91
*	Labour law	
*	Trade union law	
	Taxation	
	Taxation Law	12/28/89
	Decree on Investment Tax	02/16/90
	Law on Excise Tax	07/09/90
	Law on Social Security Tax	09/12/90
	Law on Operating License Tax	09/25/90
	Law on State Duty	09/25/90
	Law on Personal Income Tax	10/11/90
	Order on Taxation of Enterprise Income	11/23/90
	Order on Turnover Tax	11/29/90
	Law on Changes to the Taxation Law	03/28/91
	Law on Tax Concessions to Enterprises with Foreign Capital	09/10/91

* Recommended

Subject classification of existing and recommended legislation

Taxation

Decision Implementing the Law on Foreign Investment and the Law on Tax Concessions to Enterprises with Foreign Capital	09/11/91
Law on Income Tax on Enterprises	10/15/91
Law on Turnover Tax	10/16/91

* Recommended

SOVIET/AMERICAN SECURITIES LAW WORKING GROUP

The Soviet/American Securities Law Working Group ("SASLAW") provides advice and assistance to the governments of the Republics of the Commonwealth of Independent States and the Baltic States in designing and implementing the legal, regulatory and disclosure systems necessary to support fair and orderly capital markets. SASLAW's members include American practicing securities lawyers (several of whom speak Russian), an American law professor and two American accountants, as well as lawyers and economists from the former Soviet Union.

SASLAW works directly with those within each Republic's or State's government who are charged with fostering the development of securities markets and regulating them — typically, officials from the securities departments of Ministries of Finance and Central or National Banks, and from relevant legislative committees. Our work with each Republic or state proceeds in four stages:

1. Education,

2. Assistance in drafting and adopting a securities law,

3. Assistance in developing securities regulations and a disclosure system, and

4. Assistance in implementing the law, regulations and disclosure system.

To date, we have provided significant assistance to Belorus, Russia and Ukraine. We are planning an educational and drafting session in Alma Ata for Kazakhstan and the other Central Asian Republics during the middle of April, and a similar, all-Baltic session at the end of that month.

* * *

You may contact SASLAW in the United States through its American Chairman, Richard P. Bernard, Milbank, Tweed, Hadley & McCloy, at (212) 530-5650 (fax: (212) 530-5219). In Moscow, contact Robert D. Kartheiser, Milbank, Tweed, Hadley & McCloy, at phone/fax 975-2524.

Outline of
Recommended Securities Law
prepared by
Soviet-American Working Group

Preliminary Comments:

1. The Securities Law recommended herein could be enacted by the Soviet Union or by one or more republics. Precedent for the latter is to be found in Australia and Canada, where securities legislation has been enacted by the states and provinces rather than the national government. If a system of Republic regulation (similar to provincial regulation in Australia and Canada) or dual Union and Republic regulation is to develop (as is the case to a certain degree in the United States), careful attention must be paid to avoiding the economic and competitive costs resulting from duplicative and contradictory regulation. In such cases it will be necessary to determine, among other things, what contacts with a particular jurisdiction will make that jurisdiction's securities laws applicable and how to reconcile the different requirements of two or more jurisdictions when such requirements apply to the same transaction (e.g., a public offering of securities in more than one Republic).

2. It is recommended that an appropriate ministry (other than the governmental authority for securities) control access to the capital market by all governmental units within the jurisdiction, but that there be no governmental control on access (as distinguished from disclosure) to the capital market by non-governmental issuers. While some countries have had capital

market controls on non-governmental issuers, we believe that this is unwise generally and particularly for a government trying to free itself from excessive central planning.

3. The proposed Securities Law would apply to the public distribution of all securities except (a) debt securities of, or fully guaranteed by, the government and its central bank, (b) bank obligations arising in the ordinary course of commercial banking business directly with customers (as distinguished from transferable investment instruments sold through intermediaries), and (c) all debt maturing within one year incurred in the ordinary course of business. Other exemptions can be considered. The proposed Securities Law would also apply to secondary trading in all securities by all securities dealers, excluding trading by the government and its central bank.

4. The recommendation contemplates the creation of (1) one governmental regulatory authority (the "Governmental Authority") and (2) one or more self-regulatory associations ("Self-Regulatory Associations") and the delegation of very broad rule-making authority to them. Consideration must be given to any constitutional or legal problem in delegating such broad rule-making authority and imposing civil liability for violations of the rules. If it is desirable based on legislative traditions or otherwise, a greater level of detail could be included in certain areas of the Securities Law (e.g., specification of certain qualification requirements for securities dealers, more detailed specification of certain prohibitions and related

penalties, etc.) or more generally throughout the law. To preserve flexibility, however, the Governmental Authority should be given broad authority to grant exemptions from requirements under the Securities law.

If the securities requirements are to be taken seriously, a way must be found to impose criminal sanctions for serious violations. The interests of the government and the public would be protected by a requirement that the Governmental Authority and the Self-regulatory Associations adopt and modify regulations in the open, i.e., through a public notice and comment procedure.

5. The Governmental Authority, initially by itself and in time together with the Self-Regulatory Associations, would be responsible for the licensing and supervision of all securities professionals and of all stock exchanges and other securities markets, whether operated on a stand-alone basis or as a part of a commodities exchange and whether structured around a physical trading floor or through computers.

6. The recommended Securities Law is designed to accommodate the requirements of European Community ("EC") Directives, although not always directly. More generally, the recommended Securities Law is designed to erect a regulatory structure that accords with the various efforts at achieving international harmony among securities laws and practices. Such a design not only assures adoption of the "best practices" that have developed through trial and error around the world, but also

helps assure that the Soviet securities markets will not be encumbered by unnecessary barriers to their subsequent emergence as significant international capital markets. For this reason, the recommended Securities Law would also directly charge the Governmental Authority with developing the markets under its authority in accordance with international standards and, when this is not possible, positioning them for such development subsequently.

7. It is assumed that the jurisdiction has, or will have, a companies law or a portion of its commercial code which serves the purpose of a companies law, i.e., a law covering the organization of joint stock companies, the issuance of shares and debt securities, shareholders' rights etc. Particular consideration needs to be given to any changes necessary to protect bona fide purchasers of securities against unknown claims to ownership of such securities and to accommodate issuance of securities in book entry form or the transfer by book entry of interests in immobilized physical securities. Some subjects addressed herein, e.g., the ongoing reporting obligations of governmental and non-governmental issuers and the regulation of the solicitation of proxies and consents of securityholders, could be dealt with by additions to or changes in other laws rather than inclusion in the Securities Law.

8. Consideration should be given to the role of tax policy in stimulating or discouraging investment in securities. The tax system should be reviewed to determine the extent to

which specific taxes discourage or prejudice investment in securities, and higher than ordinary stamp duties and transfer taxes should be avoided. At the same time, careful study should be devoted to evaluating the use of tax incentives to encourage investment in financial assets (e.g., in the form of reduced rates of tax on dividends, capital gains, interest derived from securities ownership) or to encourage enterprises to raise external capital through public sales of securities (e.g., deductions from the tax liability of securities issuers of dividend payments, etc.).

9. It is assumed that any desired limitations on foreign investment in publicly traded securities will be handled in a more comprehensive foreign investment law.

1. Governmental Authority.

(1) The Securities Law should authorize a semi-independent agency of three to seven members to carry out and enforce compliance with the law. If there are more than three members, the additional members could serve on a part-time basis, provided they are free of conflicts of interest, e.g., experts from universities or research institutes without direct commercial interests.

(2) The Chairman and other members of the Governmental Authority would be appointed to staggered three-year terms on nomination of the [President] and approval of the [Legislature]. [No more than a bare majority of the members should be of the same political party.] They should be subject

to removal by the [Legislature] only for misfeasance or serious failure to perform their duties. No residual or oversight authority should be left in the Ministry of Finance.

(3) The Governmental Authority would have its own budget and be authorized to employ a professional staff.

> Comment: Under this approach, the Governmental Authority has a certain degree of independence from the particular government in power from time to time. This may be more apparent than real, as the legislature can always change the law and thereby modify any rules adopted by the Governmental Authority. However, it may nonetheless be important as creating a certain atmosphere that would discourage interference by the government in power. It would also enable the members to gain expertise and provide for continuity through changes of government, both of which will be important to the securities industry and markets. A semi-independent agency has the added advantage that it facilitates the hiring of an entirely new staff of persons committed to the development of a capital market rather than the assignment of nomenklatura that may not be sympathetic to such development.

(4) The Governmental Authority would be generally charged with carrying out and enforcing the Securities Law and would adopt rules to implement the various provisions of the law (for breach of which violators would be subject to civil liability and sanctions), carry out the functions of the Self-Regulatory Associations until such time as self regulation is feasible, approve or reject all rules and rule changes proposed by the Self-Regulatory Associations, and oversee the Self-Regulatory Associations. The Governmental Authority should probably be granted broad authority to exempt both generally and specifically from the requirements of the Securities Law in accordance with standards prescribed in the Law. In addition to

setting out the Governmental Authority's responsibilities in a variety of specified areas, the Securities Law would grant to the Governmental Authority broad, residual power to engage in rule-making and take other actions consistent with the purposes of the Law. The Securities Law would also direct the Governmental Authority to exercise its oversight of the markets so as to promote their adoption of rules and practices consistent with international practices and standards and, when this is not feasible, to embed in any non-conforming rules and practices the basis for evolving to international rules and practices when they become feasible.

(5) The Governmental Authority should be charged with engaging in a program of public appearances, seminars and issuance of interpretive releases designed to promote the rapid development of the securities markets and to foster understanding and respect for the Securities Law.

(6) All actions of the Governmental Authority would be appealable to the courts on grounds of non-conformity with law, especially the Securities Law.

(7) The Governmental Authority would establish its own rules as to the conduct of its activities under the Securities Law.

(8) The Governmental Authority should be required to submit to the [President] and the [Legislature] annual reports as to its activities and progress in the development of the capital market.

2. Securities Dealers, Investment Advisors and Their Representatives.

(1) The Governmental Authority would license all (a) securities dealers (those engaged in the business of buying and selling securities as a business, whether acting as agent for customers, as principal for their own account or as underwriters in public distributions), (b) investment advisors (those engaged in the business of advising others for compensation as to the purchase or sale of, investment in, or value of securities) and, potentially, securities analysts, and (c) their representatives (i.e., individuals dealing directly with customers). This would include banks insofar as they engage in a securities business or investment advice. If desirable for the purpose of simplifying regulation and supervision of such activities and insulating the bank activity from the risks of the securities activity, banks could be required to conduct such activities through a legal entity separate and distinct from the bank.

(2) The Governmental Authority should be authorized to require securities dealers and investment advisors to maintain net capital, maintain books and records, prepare and file reports, and keep custody of customers' securities and funds, in accordance with such regulations as the Governmental Authority may prescribe. With respect to a securities dealer that is part of a larger enterprise, the Governmental Authority would have power to set capital requirements for the securities dealer, the consolidated enterprise or both. In the case of securities

dealers that are also banks or affiliated with banks, the Governmental Authority and the Ministry of Finance or central bank would agree on the applicable net capital requirements.

(3) The Governmental Authority should also be authorized to conduct periodic examinations of the books and records of securities dealers and investment advisors and investigate suspicious activity and customer complaints, to require them to collect and maintain information about customers' financial ability and the types of investments that are suitable for them and follow prudential practices that take that information into account, and to create and operate, whether directly or indirectly through one or more Self-Regulatory Associations under government oversight, a self-insurance fund designed to give some protection to customers with respect to their securities and funds in the possession of securities dealers and investment advisors that fail.

> Comment: Although such a fund could be an important means of encouraging investment, the costs of the assessments necessary to create the fund could be a significant burden for an immature industry. Accordingly, unless the government were prepared to provide the initial funds, exercise of the authority to create the fund will probably have to be deferred.

(4) The Governmental Authority should be authorized to oversee securities dealers and investment advisors with respect to conduct of business, compensation and sales practices, and dissemination of market data. Its authority should extend to requiring securities dealers and investment advisors to set up internal supervisory and compliance procedures to assure

compliance with its rules and those of Self-Regulatory Associations.

(5) The Governmental Authority would be permitted to delegate certain of its functions to the Self-Regulatory Associations to be carried out under the direct supervision of the Governmental Authority.

3. Self-Regulatory Associations.

(1) The Governmental Authority should be authorized to recognize and license one or more associations or unions of securities dealers and/or investment advisors to carry out such functions of the Governmental Authority as it may delegate to them, to establish rules of good business conduct (for breach of which members may be fined, suspended, expelled or, to the extent permitted by the rules of the Governmental Authority, held liable to customers) and to examine and discipline members and their representatives for failure to comply with the Securities Law, the Governmental Authority's rules and the Self-Regulatory Associations' rules. There could be one Self-Regulatory Association comprised of all licensed securities dealers and investment advisors, with such functional, trading market or geographical subdivisions as may be appropriate. Or there could be multiple Self-Regulatory Associations, with stock exchanges and others securities markets each constituting an independent Self-Regulatory Association. In the latter case, some harmonization of their rules would be required.

Comment: Harmonization could be promoted by the Governmental Authority, using it as a criterion in

approving the rules and rule changes of Self-Regulatory Associations and promoting it through sponsorship of an all-jurisdiction council or federation of Associations.

(2) Subject to licensing and supervision by the Governmental Authority, the Self-Regulatory Association(s) would be responsible for the operation of all stock exchanges and other securities markets. Access to the exchanges and other securities markets should be open to all licensed securities dealers on a non-discriminatory basis. Consideration should be given to the extent to which trading in securities among securities dealers and with their customers should be required to take place on an exchange in order to concentrate trading, make transactions and prices visible to the marketplace and protect against conflicts of interest.

(3) Subject to the requirements imposed by the Governmental Authority for the sake of uniformity, the Self-Regulatory Association or subdivision operating an exchange or other securities market may determine how trading thereon is to be conducted. The Governmental Authority should require dissemination of quotations and reporting of transactions in the most frequently traded securities.

(4) Consideration should be given to authorizing the use of arbitration to resolve disputes among members of a Self-Regulatory Association, between members and their employees and between members and their customers.

(5) Association actions should be appealable to the Governmental Authority.

Comment: Self-regulation draws on the leaders of members, makes use of their experience in developing rules that are more effective, less intrusive and less costly, mobilizes their collective self-interest in policing good business standards, and enhances the acceptance of the substance and costs of regulation.

4. Initial and Periodic Reporting.

(1) Initial Reports. Each issuer (other than the government and central bank (if any)), when (a) the number of beneficial owners of its securities (other than exempt securities) exceeds [250?] for the first time or (b) it proposes for the first time to sell its securities (other than exempt securities) to more than [100?] persons, should be required to file with the Governmental Authority, make publicly available and distribute to its security holders an Initial Information Report containing such information as to the issuer's business, securities and management and such financial statements (audited and unaudited) as the Governmental Authority may prescribe. Exempt securities would include debt securities of the government or central bank, debt securities fully guaranteed by the government or central bank, nontransferable obligations of banks entered into directly with customers, obligations maturing within one year incurred in the ordinary course of the obligor's business [to finance short-term business requirements], true insurance policies (i.e., excluding variable annuities) and securities issued solely in exchange for other securities of the same issuer.

Comment: The Governmental Authority could look to a number of useful precedents (from the EC, the U.S.

and elsewhere) in formulating the disclosures to be contained in the Initial Information Report.

(2) Subsequent Periodic Reports. Thereafter such issuers would be required to file with the Governmental Authority, make publicly available and distribute to securityholders an Annual Report and such interim reports containing such financial and business information as the Governmental Authority may prescribe.

Comment: It is contemplated that the Governmental Authority initially would require annual and semi-annual reports and perhaps special reports to reflect certain significant developments. Thereafter it might require quarterly reports.

(3) Auditing and Accounting. In prescribing the content of Initial Information Reports and Annual Reports, the Governmental Authority would adopt or approve acceptable auditing standards and accounting principles.

Comment: It is contemplated that, with respect to non-governmental issuers, the Governmental Authority would start with the International Auditing Guidelines and International Accounting Standards being developed by the International Accounting Standards Committee. It might also wish to consider more detailed precedents from the EC, the U.S. and elsewhere. It would undoubtedly have to introduce these requirements in transitional stages. With respect to governmental issuers, the Governmental Authority might consider World Bank and International Monetary Fund ("IMF") recommendations and the pronouncements of the U.S. Governmental Accounting Standards Board. If other governmental or self-regulatory institutions do not emerge to do so, the Governmental Authority may have to engage in the direct regulation of the accounting profession and its practices.

(4) Oversight by Government Authority. Initial Information Reports, Annual Reports and interim reports would generally not be subject to pre-clearance by the Governmental

Authority. However, for reports filed by non-governmental issuers (but not by governmental issuers), the Governmental Authority would establish procedures to review some or all of such reports subsequent to their filing. The review would focus on compliance of the reports with the applicable disclosure requirements. In cases of non-compliance, the Governmental Authority would issue comments to the issuer and require the filing of appropriate amendments to correct the deficiencies.

5. Securities Distributions.

(1) An issuer, its affiliates (i.e., persons in a control relationship) and underwriters for either would be permitted to sell the issuer's securities (other than exempt securities) to the public only if there are delivered to each purchaser copies of the issuer's Initial Information Report or most recent Annual Report, any subsequent interim report(s) and a distribution supplement describing the securities being offered, the plan of distribution and any recent material developments necessary to update the Initial Information Report or Annual Report and interim reports. In lieu of such delivery of documents, issuers could be permitted to publish in newspapers of general circulation summaries of such documents and required to deliver the full documents upon request to prospective purchasers of the securities. When the Governmental Authority is satisfied that information contained in the periodic reports is being quickly absorbed in the marketplace, such reports could be incorporated by reference in the distribution supplement instead

of being physically delivered with it. In the case of securities of issuers that file Annual Reports, affiliates and their underwriters would be able to sell without issuer cooperation. At such time as institutions sophisticated in securities investment develop, sales to such institutions could be exempted from the above requirements.

(2) It is recommended that the Governmental Authority prescribe the disclosure requirements applicable to governmental issuers (other than the government itself, its central bank and other issuers insofar as their debt securities are fully guaranteed by the foregoing) and non-governmental issuers, that all such issuers be required to file the required documents with the Governmental Authority and that the Governmental Authority be authorized to review and require changes in the documents of non-governmental issuers (but not governmental issuers). The standard applied by the Governmental Authority to documents of non-governmental issuers should be that of disclosure and not merit. That is, once a non-governmental issuer has satisfied all applicable disclosure requirements, it would be entitled to proceed with its offering, whether or not the Governmental Authority liked the issuer's securities or prospects.

> Comment: The Governmental Authority's review would focus on compliance of the required documents with the applicable disclosure requirements. The review process will enhance the reliability and consistency of disclosure. Moreover, issuers in emerging capital markets lack experience and precedents and, accordingly, need the guidance of the review process.

6. Solicitation of Securityholders' Consents or Proxies to Vote.

No person should be permitted to solicit the consents or voting proxies of more than [25?] securityholders except in accordance with such procedures and upon delivery of such information as the Governmental Authority may prescribe. The procedures would include at least filing of soliciting materials with the Governmental Authority and, in the case of non-governmental issuers, their pre-clearance by the Governmental Authority. Again, the review process would address compliance with disclosure requirements and not the merits of the solicitation.

7. Acquisition of Shares; Takeovers.

(1) Significant Stockholders. Any person who acquires more than [5?]% of the outstanding voting shares of any issuer that is required to file Annual Reports should be required to report such acquisition to the Governmental Authority, any stock exchange or other market on which such shares are traded and such issuer within five business days and refrain from any acquisition of additional shares until two business days after filing such report. Such person should be subject to the same requirements with respect to the acquisition of each additional [5?]% of the issuer's outstanding voting shares.

Comment: The pattern of legislation around the world seems to be tending toward a 5% standard.

(2) Management Holdings. Management of a publicly traded company should be required to report to the Governmental

Authority, any exchange or other market on which such company's shares are traded and the company their ownership of the company's equity securities and changes in it. This will deter misuse of inside information by such persons and will disclose useful market information.

(3) Issuer Transactions in Own Shares. Issuers of publicly traded shares should be required to report their transactions in their own shares to the Governmental Authority and any exchange or other market on which the shares are traded.

(4) Tender Offers. Tender offers for shares of publicly traded companies, including issuer tender offers, should be subject to such procedural and informational requirements as the Governmental Authority may prescribe. Tender offers would have to be made to all holders of the class of stock (pro rata over the number of shares tendered if the offer is for fewer than all shares), and the same consideration would have to be paid to all tendering shareholders.

(5) Mandatory Buy-Outs. Any person proposing to acquire more than [30]% of the outstanding voting shares of a publicly traded company should be required to make a cash tender offer to all remaining holders of voting shares at the same price, which price should be at least equal to the higher of the highest price paid by the offeror for shares of the same class during the preceding 12 months or the average market price during the [30] trading days preceding announcement of the tender offer.

(6) Transactions with Affiliates. Any affiliate of a publicly traded company proposing to acquire or combine with that publicly traded company would be permitted to do so only upon compliance with such additional procedural and informational requirements as the Governmental Authority may prescribe.

> Comment: Strictly speaking, the foregoing should not be necessary in the early stages of development of a capital market. However, in these days of instant communication and rapid migration of developments, it is probably advisable to put them in place at the outset. It is certainly the case that most developing markets are doing so in one form or another.

8. Collective Investment in Securities.

The Securities Law should contemplate and provide for regulation of collective investment arrangements -- e.g., investment funds which sell shares or other interests to the public and use the proceeds to invest in a portfolio of securities. The Governmental Authority should be authorized to register such arrangements as well as their distribution to the public and establish requirements relating to capital structure, diversification of assets, redeemability, self-dealing, compensation, protection of assets, record-keeping and audits.

> Comment: In the U.S. and elsewhere, these types of arrangements have proven to be one of the most important avenues for public participation in the securities markets.

9. Publicly Traded Options, Securities-Related Futures and Short Sales.

(1) Options and Warrants. Public trading in options or warrants to purchase or sell securities (other than securities of the issuer of the option or warrant) should be permitted only

on such terms as the Governmental Authority may prescribe. Private writing of options would be permitted, but writing of options by securities dealers would be subject to regulation by the Governmental Authority.

(2) Securities-Related Futures. Securities-related futures should be prohibited until further legislative action and, when permitted, should be subject to regulation by the Governmental Authority. Commodities-related futures can be permitted immediately subject to regulation by another governmental authority. No recommendation is made with respect to currency-related futures.

(3) Short Sales. The Governmental Authority should be authorized to regulate short sales, i.e., sales of securities the seller does not own or have the right to acquire. Initially it might prohibit short selling except by securities dealers in the ordinary course of market-making and then gradually permit it more generally.

10. Securities-Related Credit.

The Securities Law should authorize the Governmental Authority to regulate lending and borrowing for the purpose of purchasing or carrying publicly traded securities (other than securities of or guaranteed by the government or central bank.

11. Abusive Practices.

(1) Fraud, Misstatements and Omissions. Knowingly or recklessly using fraud, material misstatements or material omissions in connection with the purchase or sale of securities,

the solicitation of proxies or consents or tender offers should be prohibited.

(2) Insider Trading. "Insider trading", the misuse of privileged, material, undisclosed information to trade in securities, should be prohibited.

(3) Manipulation. The Governmental Authority should be authorized to prohibit or regulate trading practices deemed to be manipulative or have manipulative potential. These would include fictitious transactions to create a false or misleading appearance of active trading or prices and purchases to facilitate a distribution.

12. Transfer, Clearance and Settlement.

(1) System. The Governmental Authority should be authorized to create and operate, either directly or through a Self-Regulatory Association under Governmental Authority oversight, a system for the transfer of record ownership of publicly traded securities (other than securities of the government and central bank), for the clearance and settlement of transactions in such securities and for the custody of such securities.

> Comment: Preferably this should be a book entry system, rather than a system based on delivery of physical certificates.

(2) Beneficial Owners. Record owners holding for beneficial owners would be required to advise issuers as to the number of beneficial owners for which they hold and to forward

reports, solicitation materials and tender offer documents to the beneficial owners.

(3) Bearer Securities. Bearer securities should not be permitted due to risk of theft and counterfeiting, expense to create and process, and the fact that they encourage tax evasion and disrespect for the law.

13. Liabilities.

This is a difficult area that must be designed in the light of local law and practice. Anyone whose conduct in violation of the Securities Law or a Governmental Authority rule directly damages another person should be liable in damages to such other person. Other violations of the Securities Law should presumably subject the violator to civil penalties at the instance of the Governmental Authority and the Self-Regulatory Associations. What sanctions? To what extent should violations be subject to criminal sanctions at the instance of public prosecutors? What fines? Imprisonment for what periods?

14. Administrative Procedure.

If not otherwise required by local administrative law, the Governmental Authority and the Self-Regulatory Associations should be required by the Securities Law to publish notice of all proposed rules, forms and other actions of general applicability, and proposed changes therein, and give those potentially affected thereby an adequate opportunity to comment thereon. In taking final action, the Governmental Authority and Self-Regulatory Associations should be required to give due consideration to such

comments and determine that the benefits of the action justify the cost of compliance.

15. Enforcement.

The Securities Law should specify the powers of the Governmental Authority and the Self-Regulatory Associations to enforce the law and their rules, provide that actions of the Self-Regulatory Associations are appealable to the Governmental Authority and actions of the Governmental Authority are appealable to the courts, and specify the extent, if any, and basis on which factual findings by the Self-Regulatory Associations or Governmental Authority are reviewable.

16. Funding.

The Governmental Authority and Self-Regulatory Associations should be authorized to charge reasonable fees in respect of all filings, applications and securities transactions. Ultimately the goal should be that these charges will fund the costs of the Governmental Authority and Self-Regulatory Associations, but this will probably take a long time. In the meanwhile the government will have to fund the excess of expenses over revenues. This could be done in stages by outright grants, then advances repayable without interest and later by advances repayable with interest. The operations of the Governmental Authority and Self-Regulatory Associations should be part of the government budgetary process at least until they become self-supporting.

SOVIET/AMERICAN SECURITIES LAW WORKING GROUP ("SASLAW")

MEETINGS ON DEVELOPMENT OF SECURITIES MARKETS, REGULATION AND DISCLOSURE IN THE BALTIC STATES

TALLINN, APRIL 27-MAY 1, 1992

TOPICS FOR GENERAL SESSIONS

Role of Regulation in Securities Markets

All Western economies regulate the distribution and trading of securities. We will discuss the important role that securities regulation plays in assuring fair and orderly securities markets, provide an overview of the topics that securities laws usually cover, and describe how government authorities, stock exchanges and broker-dealers share responsibility for regulation.

Terminology and Definitions

The varied backgrounds of the meeting participants assures that attempts to discuss concepts of securities markets, regulation and disclosure without first reaching a common level of understanding on the fundamentals will lead to disaster. We will discuss the basic differences among various types of securities and introduce other basic concepts key to an understanding of subsequent presentations.

Securities, Commercial and Corporate Laws

Securities laws work in concert with commercial and corporate laws. We will differentiate the role of securities regulation from the roles these other laws play and explore how they interact.

Disclosure-Based Securities Regulation

The disclosure of information about issuers is the heart of any system of securities regulation. We will discuss the philosophy and scope of disclosure-based regulation, describe the kinds of disclosure required by Western securities regulations and the extent to which it differs depending on the type of issuer, and identify the critical role played by accounting and auditing.

Accounting and Auditing Fundamentals

Disclosure of financial information lies at the heart of investor protection in Western securities regulation. We will explain the fundamentals of accounting and auditing and show how an investor uses financial information in making an investment decision.

Independent Agency or Not?

While some Western countries constitute an independent governmental authority to regulate their securities markets, others give the task to their ministries of finance. We will explore the reasons for and against each of these choices and the Western experience with them.

Government and Municipal Securities

Western securities laws often regulate government securities differently than corporate securities. We will address the special issues raised by the regulation of securities issued by sovereign issuers (domestic and foreign) and municipalities.

Regulation of Professional Intermediaries

Investors gain access to new issues of securities and to stock exchanges through broker-dealers and other professional intermediaries. We will describe the roles that professional intermediaries play in Western securities markets and how Western countries regulate them, noting in particular the role that financial responsibility rules play in protecting the markets.

Role of Commercial Banks in Securities Markets

Western countries have historically differed markedly in the extent to which they permit commercial banks to engage in securities activities. We will describe the policy considerations that underlie these differences and discuss techniques that Western countries use to restrict or regulate the securities activities of commercial banks.

Regulation by and of Stock Exchanges

Western stock exchanges regulate the activity of their own members and, in turn, are regulated by governmental authorities. We will describe how Western securities laws balance governmental oversight of exchanges with self-regulation, and how stock exchanges regulate their members.

Remedies and Enforcement; Insider Trading

Securities laws can accomplish little without a means for their enforcement. We will discuss how governmental regulators, stock exchanges and private individuals are empowered by Western securities laws to enforce those laws' provisions, emphasizing how such enforcement can deter insider trading.

Outline of a Proposed Securities Law

The concepts discussed in earlier presentations, as well as many other concepts, are woven together into a cohesive fabric in SASLAW's "Outline of a Proposed Securities Law". We will lead the meeting participants through a review of the outline to demonstrate its approach and to highlight some of the policy decisions that underlie the task of drafting a securities law.

Privatization and the Securities Markets

A privatization program will both benefit from and help create active securities markets. We will describe alternative approaches to privatization and those approaches' interaction with securities regulation and the securities markets.

Taxation Policy and Securities Markets

The taxation of securities transactions, interest, dividends and capital gains, as well as tax withholding practices, have important implications for the capital formation process. We will examine some of the paths that Western governments have followed in their taxation policies and their consequences.

Brokerage Operations

Running a brokerage firm is running a business. We will cover some of the key organizational and operational issues encountered in setting up and running a broker-dealer.

Creating Stock Exchanges

More than an act of the legislature is required to create a stock exchange. We will discuss the issues attending the formation and operation of a stock exchange, including its organization, market participants. regulation and trading.

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SOVIET/AMERICAN SECURITIES LAW WORKING GROUP ("SASLAW")

MEETINGS ON DEVELOPMENT OF SECURITIES MARKETS, REGULATION AND DISCLOSURE IN THE BALTIC STATES

TALLINN, APRIL 27-MAY 1, 1992

List of Participants

1.	Ivo Ounapuu	Ministry of Finance, Chief of the Department of Money Circulation
2.	Hilma Haaber	Ministry of Finance, Deputy Chief of the Deparment of Money Circulation
3.	Juhan Parts	Ministry of Justice, Leading Specialist of the Department of Commercial Law
4.	Kroot Kilvet	Bank of Estonia, Specialist of the Department of Monetary Policy
5.	Tatyana Muravyeva	Estonian Savings Bank, Deputy Chairman of the Board
6.	Ilona Undusk	Estonian Savings Bank
7.	Juri Tarmak	Baltic Association of Stock Exchanges, General Secretary
8.	Aivo Reiner	Estonian Exchange Society, General Secretary
9.	Aarne Palu	Tallinn International Stock Exchange, Currency Auctions Specialist
10.	Viktor Mahhov	Tallinn International Stock Exchange, Project Manager

11.	Yevgeni Klimov	HTM Exchange (Tallinn), President
12.	Edgar Kunnapu	HTM Exchange, Council Member
13.	Urmo Raiend	Estonian Exchange, Auctioneer
14.	Kalev Raidjoe	Estonian Exchange, Auctioneer
15.	Ieva Mirrilyuk	Rigas Birza, Department of Securities, Consultant
16.	Talis Laizans	Baltic International Exchange Academy, Director
17.	Andris Klauss	University of Latvia, Department of International Economic Relations, Ph.D.
18.	Agris Zigurs	ADS Broker (Riga), Broker
19.	Richard Zvell	Latvian Industrial Bank (Riga), Consultant
20.	Nadezhda Tarmak	Broker Baltic Ltd., (Tallinn), Vice Director
21.	Mari Lokk	Broker Baltic Ltd., Chief of Securities Department
22.	Raimondas Gabrilyovicus	Tzao "Anira" (Vilnius), Director
23.	Rimandas Klepacus	Tzao "Anira" (Vilnius), Consultant

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An Overview of Budget Policies and Procedures of the United States Government

Submitted to:
Supreme Council
Tax and Budget Committee
Republic of Estonia

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AN OVERVIEW OF BUDGET POLICIES AND PROCEDURES OF THE UNITED STATES GOVERNMENT

RANDALL D. WEISS
Deloitte & Touche
Washington, D.C.
March 1992

This paper provides an overview of the budget procedures used by the United States Government. The establishment of sound and consistent budget procedures is an essential part of creating an environment in which private enterprises can thrive. Such procedures help the private sector anticipate the volume of productive inputs (e.g., labor and materials) which will be purchased by the government. Budget procedures also allow the private sector to know to what extent the government will meet these financing requirements through the imposition of taxes and other types of receipts, or conversely, through borrowing. These activities of the government have a substantial effect on labor and financial markets, and the ability of private enterprises to know the government's participation in the economy allows it to adjust in an orderly fashion to the effects on these markets.

To aid the understanding of budget procedures that may be appropriate in a market economy, this paper provides an overview of the budget procedures used by the national (Federal) government; state and local governments are not discussed. These procedures reflect, of course, the particular history and institutions of the United States. An especially important part

of understanding the context of these procedures is the separation of powers between the Executive and the Legislative branches of government, as prescribed in the U.S. Constitution. Laws are enacted only after the Congress approves a law and the President, who is elected separately from members of Congress, concurs with the enactment. The Congress, therefore, has developed independent budget procedures and analytic and oversight capabilities that might not be necessary if this separation of powers did not exist, as in a parliamentary form of government. This paper therefore does not describe certain recently developed procedures and agencies, such as the Congressional budget process and the Congressional Budget Office, which result from Congress's desire to maintain the ability to formulate budget policy independently from the executive branch. The paper also excludes the automatic procedures, called sequestration, for cutting spending in certain situations in which recently enacted laws have increased the budget deficit.

The legal concepts and administrative procedures governing the authority to spend money are the first topic covered. These include the laws authorizing the appropriation of funds, the appropriations laws themselves, and the apportionment of appropriated funds by the Office of Management and Budget, an agency of the Executive Office of the President. Description of the government's various auditing and oversight functions, designed to insure compliance with these laws, follows.

The next part of the paper describes the budget planning process used by the U.S. government. Substantial planning activities precede the enactment of spending laws. These activities, including the projection of

government-wide outlays and receipts, lead to the annual presentation to the Congress of the President's budget proposals for the upcoming fiscal year. Implementation of this process is coordinated by the Office of Management and Budget according to a standard timetable. The process requires the use of common projections of economic variables (such as inflation and interest rates), standardized concepts of measurement (such as the treatment of loans and loan guarantees), and definition of which activities are included in the budget (such as the treatment of "off-budget" activities and government sponsored enterprises).

I. LEGAL CONCEPTS AND PROCEDURES

A. Authorization and Appropriations Laws

The basic framework for the legal structure for spending authority derives from the U.S. Constitution, which provides simply that "No money shall be drawn from the Treasury but in consequence of appropriations made by law." Thus, no government agency may incur the obligation to make payments unless the authority to obligate those funds is specifically provided in a law. Further, the agency may use such authority only for the purposes provided in the law and according to any restrictions so provided.

The purposes for which a particular program of spending is to be made, and the actual authority to incur government obligations for that program, often are provided in two separate laws, known as authorization and appropriations laws, respectively.

Authorization laws are the ones which establish Federal agencies, the terms under which they operate, and the policies which they are to carry out. The organizational structure of the agency and duties of its key personnel are also specified in these laws. Authorization measures also may specify the purposes of particular spending programs run by these agencies. These laws may be either permanent or temporary, depending on the desire to force periodic review of the purposes of the program or agency. In addition, authorization laws may impose a limit on the amount

of actual spending authority which may be granted by the separate appropriations law.

The appropriations laws are the ones that actually provide agencies the legal authority to obligate funds, and for the Treasury Department to make payments to discharge those obligations. Examples of government obligations are awarding contracts, placing orders, accepting goods and services, or other actions which commit the government to make a payment. Authority to incur these obligations is termed "budget authority." Appropriations for many programs are made solely for one fiscal year (which lasts from October 1 until the following September 30), so that any unused authority generally expires at the end of that year. The appropriations laws do not directly control the timing of the actual outlays (payments) made by the Treasury; this depends on how long it may take for goods or services to be provided after the government obligates itself to pay for such items and on the payment terms that may be negotiated with vendors.

Appropriations laws specify the specific numerical level of spending authority by account. Accounts are relatively broad, so that it typical for a government agency to have a single account to cover all of its operations expense. Other accounts may be provided for other uses of funds. such as construction. Sometimes, however, appropriations measures do earmark separate amounts for particular activities within accounts.

After the enactment of the appropriations laws for a particular year, funds may be shifted among accounts only by enacting new laws. In

addition, the ways in which funds are used within an account by a particular agency must be consistent with whatever detailed justification materials the agency may have submitted with its appropriations request, unless the agency receives permission of the committees of the Congress which originate the appropriations laws.

In some cases, separate authorization and appropriations laws are not enacted, because a single statute combines the authorization of a program and the legal obligation to commit funds for the program. The largest category of such cases involves so-called "entitlement" programs, under which individuals (or political subdivisions) that meet certain criteria are given the legal right to receive payments of a size specified in the law. Because the legal rights conferred on eligible recipients dictate that the government is obligated to make the payments, there ususally is no limit on the total funds that may be spent on such programs. Further, the legislation providing for such programs typically does not have an expiration date, so that changing the spending levels resulting from the eligibility and payment formulas under such laws requires an amendment in the formulas themselves. Examples of entitlement laws are those establishing programs which provide cash benefits, such as social security, and health care to needy and retired individuals.

B. Implementation of Spending Laws

Even after appropriations laws are enacted, government agencies are not free to obligate the appropriated amounts. The implementation of these laws follows several steps, coordinated by the Office of Management and

Budget(OMB). OMB plays a key role, not just in implementation, but also in the budget planning process described in the next section.

First, OMB apportions the appropriated funds to agencies and programs. Apportionment also involves the allocation of an annual appropriation to shorter time periods during the fiscal year (typically calendar quarters) so that agencies do not spend at a rate that leaves them short of funds at the end of the fiscal year.

After OMB has apportioned funds, agencies are free to incur obligations to make payments. Before the payments are actually made, the agency must certify that the goods or services received under the obligation were consistent with the authorization, appropriation, and any other laws applicable to the outlay. This certification must be in a form that may be audited. Payments are actually made by the Treasury Department, which also checks to be sure that the spending has been authorized.

Post-audit activity is performed by the agency itself and by the General Accounting Office, an agency established by the Congress to insure that all government agencies abide by the restrictions contained in the laws providing the authority to spend money. This agency also is empowered to make rulings determining whether particular items of expenditure are allowed to be made under the relevant authorization and appropriations laws. As part of this authority, the General Accounting Office also has the power to approve the accounting systems used by all Federal agencies.

Each agency is required to file annual reports with the Treasury Department valuing assets and liabilities and showing the status of all spending accounts. These are combined into an annual government-wide report published each year.

C. Revenue and Debt Management Laws

The U.S. Constitution gives the Congress the power to provide for taxes, implemented under laws consolidated in the Internal Revenue Code. Unlike appropriations laws, which provide spending authority that often is temporary, tax laws are permanent, although they are frequently amended. Although most government collections are in the form of tax receipts, some collections are treated as negative spending because of their discretionary nature. These include amounts received from the public that result from business-like or market-oriented activities, including fees for the use of specific government-owned property or specific government-provided services. In some cases, these collections are available to be spent without any further appropriations action. Government receipts may be earmarked for deposit into a fund whose use is restricted to a particular purpose (e.g., gasoline taxes are deposited into a trust fund used to finance expenditures on roads and other transportation projects), although the bulk of receipts is not so allocated.

As noted above, payments to discharge government obligations are made by the Treasury Department. Taxes also are collected by the Treasury Department. Thus, Treasury is in a position to anticipate needs to borrow funds to make up for the gap between receipts and outlays. Subject to an

aggregate limitation which is periodically increased, the Treasury Department has the authority to borrow funds as needed to meet government obligations.

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II. THE BUDGET PLANNING PROCESS

A long and elaborate budget planning process precedes the enactment of the appropriations laws described in the previous section. In the February before the October start of any fiscal year, the President submits to Congress his budget recommendations. The formulation of the budget occupies the year before its submission. During the same period, agencies are dealing with enactment of spending measures for the current fiscal year . Thus the initial stages of the planning process are carried out under considerable uncertainty. At the end of the process, the President's budget includes requests for specific appropriations laws and changes to other laws affecting spending and revenues, as well as projections of what the levels of outlays and receipts would be if the President's proposals are adopted.

A. Assembling the Budget

Each agency starts the budge process by formulate its own budget request and submitting it to OMB approximately six months before the final budget submitted to the Congress. OMB, which engages in continual study of major policy and management issues, coordinates the process for the entire government. OMB makes the actual decisions as to whether a particular agency's request finally appears in the budget and what modifications may be necessary. Each agency has the opportunity to questions OMB's decision, and, if it so desires, to appeal OMB's decision

directly to the President, who makes the final decisions about these issues.

Because the President's budget package represents the final decisions about the Executive Branch's budget proposals, agencies are prohibited from submitting their budget requests directly to the Congress, and agency proposals which are part of the negotiations with OMB are supposed to remain confidential. Further, each agency is supposed to defend the President's budget proposals affecting it, even though it may have disagreed with the OMB decisions concerning its proposals. In order to insure consistency between each agency's public statements and the decisions embodied in the President's budget proposals, OMB must approve any submission an agency makes to the Congress.

B. Budget Projections

The President's budget contains projections of total government outlays, total receipts, and the budget deficit, which is the difference between outlays and receipts. Because Federal spending and revenue laws have a significant effect on the economy, the President's budget decisions reflect the Administration's assessment of the overall economic situation, including output of goods and services, price and employment levels, and unemployment rate. The budget includes an economic forecast for the economy for the few years after the fiscal year for which the budget is issued. This forecast is used consistently for projecting any budget item, such as revenues, interest payments on the national debt, or social security payments, whose amount depends on the economic

projections. In many cases, the forecasts of revenues or outlays are highly sensitive to the particular economic projections chosen. The budget document contains information on how the estimates of outlays and receipts under the President's budget proposal would change if assumptions about such factors as inflation or interest rates changed.

The President's budget also contains detailed information on requested budget authority, and projected outlays resulting from that spending authority, by agency and account. For this purpose, offsetting collections treated as negative outlays generally are offset against the spending of the agency or account to which they are related. These amounts also are grouped by broad purpose, called functional categories, such as national defense, international affairs, agriculture, and transportation. This presentation sometimes divides the spending of particular agencies among categories; for example, some portion of the budget of the Department of Energy falls into the national defense category because the Energy Department maintains facilities for the production of fuel for nuclear weapons.

Information on projected revenues also is included in the budget, with total revenue expected for each year subdivided by type of tax. Separate forecasts are provided for the revenue effects of any tax law changes proposed by the President.

In order to provide useful information on the impact of proposed changes in spending programs, the budget also provides information on what spending would be under so-called "baseline" conditions. Baseline

projections of spending under various programs represent the levels that would be expected if no change is made in the policy governing the level of services provided. For many programs subject to annual appropriations, the baseline is simply the current year's spending amount adjusted for anticipated inflation. For entitlement programs, the baseline is simply the projection of spending under the assumption that the law authorizing the program is unchanged, but taking account of projected future inflation, unemployment rates, and other economic or demographic variables which affect future spending. These baseline estimates serve as a reference point for measuring the impact of proposed policy changes on spending in affected programs.

Because the spending laws eventually enacted differ from those proposed in the President's budget, OMB updates its budget projections to reflect the enacted laws. Revisions also occur on a regular basis as economic assumptions are changed.

C. Scope of the Budget

Although the budget is most useful in assessing economic impact of Federal government activity if its coverage is as broad as possible, certain governmental and quasi-governmental activities are not included within its purview. Examples of these are the accounts of so-called government-sponsored enterprises, which are deemed to be private. Even though they were established by the government, it has no ownership interest in them and does not control or review their budgets. These

enterprises, such as the Federal National Mortgage Association, typically engage in credit market activities.

Another important agency excluded from the budget is the Federal Reserve System, an independent entity which serves as the central bank for the United States. Because of its credit market responsibilities, it owns a large volume of interest-bearing U.S. government debt. Any such income it receives, net of its operating expenses, must be deposited in the U.S. Treasury. Such earnings are recorded as receipts in the U.S. government budget.

For the relatively few government-owned business enterprises, the budget records the net activity of the entity, that is, outlays net of receipts. Typically, the receipts of such enterprises are available to it for use without any appropriations law, so the net figure corresponds more accurately to the level of control over the enterprises than would a presentation that showed gross outlays and gross receipts separately.

Finally, the volume of direct loans and loan guarantees are excluded from the budget. Rather, as explained in the next section, the budget includes the value, over the life of the loan or loan guarantee, of the subsidy to the recipient attributable to the availability of the funds.

The above exclusions apply in compiling the spending, outlays, and budget deficit under the so-called "consolidated" budget. Tabulations also are presented using a concept which excludes the flows of the social security system and the postal service, and an even narrower concept, called the

Federal funds budget, which excludes the receipts earmarked for trust funds (because they are available only for certain types of spending) and the outlays financed by these trust fund receipts.

D. Accounting for Direct Loans and Loan Guarantees

Some government programs call for direct loans or loan guarantees rather than unconditional payments. A direct loan is a payment of funds under an agreement that requires the repayment of funds (with or without interest). A loan guarantee is any type of pledge made by the government to insure payment of principal or interest on any loan from a non-government lender to a non-government borrower. The U.S. government recently adopted a new method for budget accounting for these types of transactions so the effect on the budget is the same whichever of these two forms the transaction takes.

Before 1992, the budget accounted for these transactions only to the extent that they created cash flows. Thus, for direct loans, the initial payment of funds to the recipient was treated as an outlay, just the same as if it were a grant or a lump-sum payment. The subsequent interest and principal payments were treated as negative outlays in the year that the debtor made these payments. On the other hand, a loan guarantee led to an budget outlay only if and when the recipient defaulted on the loan and the government thus was required to make a payment to the private lender.

This accounting method created several problems. For example, direct loans created a budget outlay in the year it was made, even though a loan

guarantee with the same economic value to the recipient had no effect on the budget in that year (unless there was a quick default). A grant had the same budget effect as a direct loan of equal amount , even though the latter required repayment. Because of pressure to minimize government outlays, this treatment skewed the form of assistance according to its budget treatment rather than its true economic cost to the government.

In order to avoid these problems, legislation was enacted in 1990 to change the accounting method for these transactions. Effective in 1992, the budget cost (outlays) of a direct loan or loan guarantee program is defined to be the subsidy value and is recorded in the budget in the year of the transaction. This treatment also applies to the appropriations legislation providing the budget authority for the government to make the transaction. The subsidy value is the net present value of the cash flows attributable to the transaction, using the government borrowing rate to discount these flows. Thus, a direct loan has a budget cost only to the extent that the interest rate is less than the government borrowing rate or there is a risk that the borrower will default on the obligation. The cost attributable to default risk thus can be fully offset by raising the interest rate on the loan sufficiently above the government borrowing rate or charging the borrower a fee for the transaction. The eventual success of this new method will depend on the accuracy of the estimates of default risk; even though these estimates are made by category, rather than individually, they are still quite difficult to make, especially for a new program for which experience is not available.

III. CONCLUSION

The concepts and procedures described in this paper have been changed continually to reflect new needs for information and new ideas concerning the proper scope of laws governing these procedures. Indeed, virtually all of the content of this paper is reflected in specific laws, rather than simply executive procedures. The new methods for accounting for loans and loan guarantees required the enactment of a new law. Although each nation has its own institutional requirements, the budget laws and procedures of the United States should provide helpful guidance to any country undertaking a thorough review of its own budget framework.

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Deloitte & Touche

Republic of Estonia

Phase II Report

Volume 2

In Association With:
Development Alternatives, Inc.
Geonomics Institute
Milbank, Tweed, Hadley & McCloy
Multinational Strategies, Inc.

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U.S. Agency for International Development
EUR/RME/ER/ED

May 15, 1992

Deloitte Touche Tohmatsu International

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8 Electronics Industry Investor Guide
9 Voucher System Conceptual Design

Legislative Assistance Report Appendices:

Annex A: Compendium of Estonian Legal Documents (2 volumes)
Annex B: Sample Edition of Congressional Record and
Annex C: Sample Edition of Federal Register (1 volume)

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March 31, 1992

Ms. Siiri Ollerma
Foreign Relations Consultant
Ministry of Finance
Republic of Estonia

Dear Ms. Ollerma:

To follow up on our meetings last week, I am enclosing copies of recent tax treaties negotiated by Denmark, Germany and Sweden. I have chosen treaties they negotiated with both developing and Eastern European countries. These treaties will give you an idea of the concessions Denmark, Germany and Sweden are prepared to make in negotiating a treaty.

When I was in Stockholm, I spoke about tax treaties with Johan Salsbäck, who is the Undersecretary for Fiscal Affairs. He indicated that Sweden submitted identical proposed drafts (except for the name of the tax treaty partner) to Estonia, Latvia and Lithuania. He further indicated that he believes Sweden, Norway, Finland, and possibly Denmark will propose (probably at the Copenhagen meeting) that a single treaty be negotiated between the Nordic countries and the three Baltic countries. This may be an attractive way to go if Estonia, Latvia and Lithuania can agree to work together. It would be somewhat more difficult to negotiate a multilateral treaty than a treaty with a single country, but it may be easier to negotiate a multilateral treaty than separate treaties with each of the four Nordic countries. I believe the Nordic countries will want to be reasonable to ensure that a treaty agreement is reached. (I should note that multilateral treaties are uncommon, but in 1987 Denmark, Finland, Iceland, Norway and Sweden included a multilateral income and capital tax treaty.)

As I look back on our meetings, there is one point I should have made about withholding tax rates. Though Estonia does not now impose withholding taxes on foreign remittances (dividends, interest, and royalties), a tax treaty will limit the withholding tax rates that Estonia could impose in the future. Potential

foreign investors covered by the treaty would view this limitation on withholding tax rates as an important feature of the treaty as one fear that foreign investors have is that the host country will sharply increase taxes on remittances after the investment is made.

Let me close by saying how much I enjoyed working with you and your colleagues. Please contact me when I can be of help.

Sincerely,

Emil M. Sunley

Emil M. Sunley

EMS:bf

(Income) Tax Treaties Enclosures:
Denmark-Bulgaria
Denmark-India
Denmark-Singapore
Germany-Bulgaria
Germany-Yugoslavia
Germany-Zimbabwe
Sweden-India
Sweden-Indonesia
Sweden-Zimbabwe

Emil M. Sunley
February 4, 1992

SOME NOTES ON TAX TREATIES

What are Tax Treaties?

The two primary purposes of bilateral income tax treaties are (a) to mitigate double taxation of income and (b) to provide mutual assistance in combating tax avoidance and evasion.

With respect to the first purpose, income tax treaties divide the taxing jurisdiction between the two countries that are parties to the tax treaty. In general, with respect to a particular item of income, the country in which the income arises (the source country) is required by the treaty to reduce or eliminate its tax in favor of tax by the country of residence of the recipient. In return, the country of which the taxpayer is a resident is obligated to relieve double taxation, to the extent that a tax is imposed in the source country, by allowing a credit for the source country tax or exempting the income from its tax, as the case may be.

In the normal treaty relationship, there are flows of income in both directions; therefore, each country will cede all or a portion of its right to tax certain income from sources in its country and each country will provide relief with respect to income of its residents from sources in the other country. In that regard, income tax treaties generally provide for reduced rate of tax at source on investment income (dividends, interest and royalties) by the host country so that the aggregate tax burden on the investor will not exceed that which he would pay if he invested at home.

With respect to exchange of information, tax treaties provide elaborate mechanisms for each contracting state to, among other things, obtain tax-related information with respect to their residents and other taxpayers and consult with the tax authorities of the other state on measures to prevent the avoidance and evasion of taxes.

Tax Treaties for Estonia

Estonia may already be a successor party to a number of income tax treaties concluded by the former Soviet Union. The question of whether any of these treaties carry over to Estonia probably depends on (1) the position Estonia takes and (2) the laws and/or position of each treaty partner with the former Soviet Union. The issue of whether Estonia is a successor party goes beyond income tax treaties as the Soviet Union had many kinds of treaties in force. It is our understanding that the issue is

undecided in the United States. As the United States never recognized Estonia as part of the Soviet Union. the U.S. - Soviet Union income tax treaty arguably may never have applied to Estonia. Even if the U.S. - Soviet Union treaty does apply, it is very deficient in that the tax system of Estonia bears little resemblance to the tax system of the Soviet Union.

Estonia could gain from treaties with developed countries that are willing to include tax sparing provisions in their treaties. Under a tax sparing provision, a treaty partner would allow a credit for Estonian tax that was spared or forgiven as a result of tax incentives such as a tax holiday. Developed countries such as Sweden and Germany only provide tax sparing in their treaties with developing countries and the issue, therefore, is whether Estonia will be considered a developed or a developing country by developed countries that traditionally have been willing to include tax sparing in their treaties.

Estonia may have little to gain and much to lose from traditional treaties between developed countries. This is due to the one-way flow of investment and the greater dependence of Estonia than developed countries on taxing domestic source income. In short, if the dividend flows between Estonia and a treaty partner are essentially one way from Estonia to the treaty party, any mutual reduction in withholding tax on investment income will have a negative net impact on Estonia tax receipts.

Multinational companies place some value on the increased certainty and openness created by a tax treaty and thus a network of treaties would improve the investment climate of Estonia. Furthermore, with some concentrated effort, it may be possible for Estonia to derive some benefits through exchanges of information as provided for in treaties. This potential benefit should not be exaggerated, however, and the potential benefits in no way match the real revenue losses that can be suffered by lowering taxes on foreign investment.

This suggests that the following principles might be the basis for future treaty negotiations:

1. No significant reductions of tax revenues either through rate reductions or through narrowing of source jurisdiction.

2. Emphasis on mechanisms for dispute resolution to provide more certainty to potential investors.

3. Emphasis on cooperation to improve tax administration through meaningful exchanges of information, technical assistance and training of tax officials and "competent authority" communication.

4. Maintaining flexibility to alter future laws in accordance with public policy.

These principles can provide mutual benefits to both treaty partners without causing either party significant revenue losses.

Mini Treaty

Given the rudimentary state of the Estonian income tax law, Estonia may want to consider negotiating mini treaties at this time. A mini treaty would cover only a few topics, such as fiscal domicile, elimination of double taxation, mutual agreement and competent authority procedures, and exchanges of information. All of the other traditional topics would be left exclusively to the parties' domestic tax laws. Such a mini treaty would put the emphasis where it should be, on improving cooperation in tax administration and opening new avenues for consultation and dispute resolution.

Negotiating a Tax Treaty

Thorough research should be done before negotiations begin. Research is the most important guarantee of effective negotiation in any type of contract. In the case of tax treaties, negotiators could benefit significantly by being familiar with:

1. the flow of funds between the two countries
    - a. amount and types of foreign investment and trade
    - b. resulting flows of dividends, interest, rentals, royalties
    - c. employment of foreign personnel (as consultants, employees,

teachers, students, professionals, etc.)

2. the domestic tax laws of the treaty partner, including

   a. tax rates

   b. unilateral double taxation relief provisions

   c. other tax treaties negotiated

The more familiar that negotiators are with the economic interaction between Estonia and a treaty partner, the more they will be able to identify the most important interest of the other party in the negotiations. This information is also crucial in estimating the revenue implications of proposed treaty provisions.

OECD Course

It is our understanding that the OECD at the end of March is going to offer a course on tax treaties. The course should cover not only how treaties are negotiated but also the standard provisions in the OECD and U.N. model treaties. If Estonia is interested in pursuing tax treaties, someone should attend that course.

THE CHALLENGES OF TRANSFER PRICING

by

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for

The Government of Estonia

Emil M. Sunley
February 3, 1992

THE CHALLENGES OF TRANSFER PRICING

1. Prices charged between related parties do not represent the free play of market forces and may diverge from prices that unrelated parties would have agreed upon in an open market. Commonly controlled companies can write contracts among themselves without implying anything about the actual economic conduct of those firms. These contracts will affect the allocation of profit among the controlled companies.

For example, a Swedish parent manufactures products and sells to a related Estonian distributor. If the transfer price is high, profit will be high in Sweden and low in Estonia. If the transfer price is low, profit will be high in Estonia and low in Sweden. A second example: a U.S. company may purchase products manufactured in Estonia by a related company. If the U.S. company pays a low price, profit will be high in the United States and low in Estonia. If the U.S. company pays a high price, profit will be high in Estonia and low in the United States.

2. We usually think of transfer pricing affecting the allocation of profit between two foreign countries. Transfer prices can also be important between related companies within a single country if one of the companies operates in a low tax zone or if the

company is nontaxable due to tax holidays or other tax incentives.

3. There are many kinds of related party transactions. First, sales of goods. For example, a parent company may manufacture goods and sell to a related distributor. Second, companies may provide services to a related party. Services include technical assistance, trouble shooting, legal and accounting services, and management services. Third, companies may provide intangibles (that is, assets with no physical substance) to related parties. The intangibles may be manufacturing intangibles such as patents, know-how, designs or models; or, they can be marketing intangibles such as trademarks and trade names. Intangibles can be transferred outright or licensed. Fourth, companies may grant loans to related parties. When a parent company grants a loan to a subsidiary, it may be difficult to distinguish the loan from an equity contribution. Many countries have thin capitalization rules to limit abuse in this area, but this is beyond the scope of this paper. If a subsidiary makes a loan to a parent, it may be difficult to distinguish the loan from a dividend. So, in summary, related party transactions include sales of goods, provision of services, intangibles and loans.

4. Under the laws of most countries, related parties are required to conduct business transactions on an arm's length basis. The goal is to place the controlled taxpayer in a tax parity with an uncontrolled taxpayer. Under U.S. rules, the arm's length price is that price which would have been agreed upon between unrelated parties in the same

or similar transactions under the same or similar conditions in an open market.

5. The principle of arm's length prices is easy to state. Determination of arm's length prices is not easy. In a particular situation, there clearly are prices that are not arm's length -- they are either too high or too low. There well may be a range of prices that are arm's length. All too often, tax authorities approach transfer pricing with the naive view that there is a correct or right transfer price in any given situation. If the taxpayer will supply all relevant information, the correct transfer price can be determined.

6. In the United States, the tax authorities have stepped up the audit of transfer prices, and some cases involve $10 million, $20 million or even $100 million. There clearly are domestic and foreign companies that have chosen transfer prices to minimize the amount of taxes paid in the United States. The tax authorities, however, have also attacked transfer prices that are arm's length. It is very difficult for a taxpayer to prove its transfer prices are reasonable when they have been questioned by the tax authorities.

7. The first step in monitoring and auditing transfer prices is to require companies with related party transactions to provide information on its related parties and related-party transactions. There should be penalties for failure to file this information. The information required to be filed should not be so onerous that foreign investment is discouraged.

8. When examining transfer prices adopted by related parties, it is best to begin by analyzing the functions of the various related entities. Virtually all cases can be reduced to the following questions:

a. What was done?

b. What economically significant functions were involved in doing it?

c. Who performed each function?

d. What is the measure of the economic value of each function performed by each party?

e. What economic risks were assumed?

f. Are there any valuable intangibles used in performing the given function?

9. To understand the various methods of examining transfer prices, one must have an understanding of the basic financial reports of Western accounting. I have prepared a simplified income statement and balance sheet. First, let us look at the income statement. The income statement is a report of a company's revenues and associated

expenses and losses and the resulting net income for a period of time. The balance sheet is a report of a company's assets, liabilities, and equities. The balance sheet gets its name from the fact that the sum of the assets equals the sum of the liabilities plus equities. The balance sheet is usually as of the last day of the company's fiscal year.

10. The allowable methods for establishing an transfer price include 1) comparable uncontrolled prices, 2) the resale price method, 3) the cost-plus method, and 4) a method similar to any of the above methods. I want to give you an understanding of the economic logic underlying the various methods for determining transfer prices.

11. The first method is the comparable uncontrolled price. Under this method, the price of a sale between related companies is equal to the price paid in a comparable uncontrolled sale after adjusting for differences between the controlled and uncontrolled sale. Uncontrolled sales are considered comparable to controlled sales if the physical property and circumstances of the sale are identical to those in the uncontrolled sale or if the differences between the two have no effect on price or can be accounted for by a reasonable number of adjustments to the uncontrolled sale price.

The rationale for giving priority to uncontrolled sales is that the self-interest of any independent firm would dictate that such a firm would never pay more for any product

than the price for which the same product could be obtained from an alternative seller. Also, no independent firm would ever accept less, when selling the product, than the price it could obtain from an alternative buyer.

It is often difficult in practice to find comparable uncontrolled prices. Potential sales that may yield comparable uncontrolled prices often involve different products sold in the same market or the same product sold in different markets. It may not be possible to adjust for the differences in markets or the differences in products.

12. The second method is the resale price method. This method looks to the gross profit margin of the buyer or the reseller. Gross margin equals sales less cost of goods sold. For example, if the product sold by a manufacturer to a related distributor is a motorcycle, the method asks what margin is obtained by re-sellers of other similar motorcycles when those resellers deal with their suppliers at arm's length. The rationale of this method is that if the manufacturer had dealt with independent re-sellers, it would have had to concede a similar margin to obtain the services of those resellers. Therefore, under the resale price method, the price for a controlled sale is determined by first reducing the applicable resale price by the appropriate markup percentage. In determining whether resellers are comparable, one must look at the type of property sold, the functions performed by the re-sellers, the effect on price of any market intangibles, and the geographic market.

13. The third method is the cost-plus method. The cost-plus method looks to the alternatives facing the buyer of the product - not the seller. The rationale for this method is that an independent buyer would pay no more for the product than what it would have to pay an alternative seller.

The most appropriate gross margin percentage is the gross margin percentage earned by the seller or another party on the uncontrolled sales of property which are most similar to the controlled sale in question. Thus, under the cost-plus method, the arm's length price is computed by adding to the cost of producing such property an amount equal to the cost multiplied by the appropriate gross margin percentage. To determine whether sales of property are similar for purposes of applying the cost-plus method, we must look at the type of property sold, the functions performed by the re-seller, the effect of any intangible property, and the geographic market.

14. Now, let me briefly describe other methods that are commonly used. The Berry ratio, named after Professor Charles Berry of Princeton University, looks to the ratio of gross profit margin to operating expenses. The critical assumption underlying this method is that companies performing similar functions must earn about the same gross profit margin on their operating expenses. This is probably only true if there are no significant differences in capital intensity. If one company employs more capital, then it needs a higher gross profit margin to earn an appropriate return on its capital.

15. The methods we have discussed up to now only look at the income statement. Profit split and return-on-capital methods will require data from the balance sheet and the income statement. These methods are usually applied product line by product line. It is usually difficult to get product line data and the data one gets depend on balance sheet allocations that often are arbitrary even though reasonable. Important assets such as intangibles may not be capitalized on the balance sheet, understating the assets of the company. The rationale for these methods is that capital is allocated among different uses based on expected rates of return. For example, a foreign company would only invest in Estonia if it expected to earn an adequate rate of return on that investment. The market does not guarantee that a firm will earn the expected rate of return. Some investments turn out better than expected; others worse than expected.

16. Having discussed the basic methods that are commonly used to determine transfer prices and having briefly described the rationale for each, let me repeat that determining appropriate transfer prices is not easy. First, comparables are often hard to find. Second, even if comparables are found, the data may require arbitrary adjustment. Third, and more important, there often are significant and unique manufacturing and marketing intangibles associated with the transfer of tangible property. These intangibles are difficult to value. Sometimes it is not even clear whether the buyer or the seller owns the intangible.

17. Given all these difficulties in determining transfer prices, let me describe some alternatives that many countries have considered.

A. **Safe harbors**. Safe harbors are simple, mechanical, bright-line tests that may be used in lieu of a fact-specific arm's length inquiry. If safe harbors are mandatory for the government and the taxpayer, they can be quite arbitrary. If they are an alternative that taxpayers may elect, they can be troublesome to governments because taxpayers generally will elect the safe harbor only if it produces a lower tax liability.

B. **Formulary apportionment**. Some commentators have concluded that the standard of arm's length prices is an ideal that will never be realized. The costs and uncertainties of the current system are too high. An alternative would be an arbitrary apportionment of profits. A 50-50 profit split would be an example of an arbitrary apportionment of profits. Another example would be a required rate of return on assets. This required rate of return could be a minimum rate, as in the case of the recent Mexican law.

The Mexican Assets Tax Law imposes a tax based on the average yearly value of assets of Mexican legal entities. Any regular income tax paid by the entity can be credited against the asset tax. Thus, the Mexican Asset Tax has a net effect only if the liability under this tax exceeds the regular income tax.

Arbitrary formulas, on average, can produce reasonable results but there is no guarantee they will do so. We must recognize that arbitrary formulas do not produce the same result as arm's length prices. At the international level, they can result in double taxation of some income and undertaxation of other income.

I have tried to provide an overview of transfer price issues. There are a number of important issues I have not covered. In closing, let me list some of them:

1. Cost sharing arrangements for research and development expenses

2. Exchange rate risk

3. The question of whether cash flows take place following a transfer price adjustment

4. Secondary tax consequences of a transfer price adjustment; namely, deemed dividends to parent companies and deemed contributions of capital to subsidiary companies

5. Whether interest is charged on any deficiency in tax or paid on any refund

6. Competent authority procedure under tax treaties

7. Advance pricing agreements as proposed in the United States

8. Parent company data

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Simplified Income Statement

Net sales	1,000
Cost of goods sold	800
Gross margin	200
Selling and administrative expenses	190
Operating income	10
Interest expense	15
Net income	-5

- - - - -

Simplified Balance Sheet

Current assets			Current Liabilities	
Cash	10		Notes payable	0
Accounts receivable	80		Accounts payable	50
Inventories	110			
		200	Long-term liabilities	
Investments		0	Long-term debt	150
Plant and Equipment (less depreciation)		40	Owners' equity	100
Other assets				
Patents and copyrights		60		
Total assets		300	Total liabilities and owners' equity	300

Net sales. Total sales revenue reduced by sales returns and allowances.

Cost of goods sold. The sum of all costs required to acquire and prepare goods for sale. In the case of a distributor, these costs include the purchase cost of merchandise plus the costs of transportation in, receiving and inspection, and storage. In the case of a manufacturer, these costs include the cost of raw materials, labor and overhead.

Gross margin. The excess of revenue over cost of goods sold.

Selling expenses. Expenses incurred in promotion, marketing and distribution activities; examples include advertising, sales commissions and product shipping costs.

Administrative expenses. Expenses of a firm's central office and general support services, including R&D.

Operating income. The excess of revenue over cost of goods sold and selling and administrative expenses.

Interest expense. The cost of using borrowed money during the current period.

Net income. The excess of revenue over all related expenses.

Current assets. Assets expected to be sold, used or converted into cash within one year. Current assets include cash, accounts receivable and inventories.

Investments. Securities of other companies acquired on a long-term basis.

Plant and equipment. Land, buildings, and machinery and equipment valued at historic cost less accumulated depreciation.

Other assets. Intangible assets other than investments such as goodwill, organization costs, and patents and copyrights.

Current liabilities. An obligation expected to be paid or met by the use of current assets within one year.

Notes payable. An obligation to pay a stated amount on or by a certain date usually specifying an interest rate.

Accounts payable. Amounts owed to others, often restricted to amounts due to suppliers.

Long-term liabilities. An obligation or debt not classified as a current liability. Includes long-term debt.

Owners' equity. The interest of the owners of a company in its

assets, derived from amounts invested by the owners plus profits retained in the business. Owners' equity is a residual equal to total assets minus total liabilities.

Transfer Price Terms

Functional analysis. A determination of all functions performed by the parent company and the subsidiary. Of paramount importance is the relative importance of the functions in terms of contribution to the total profit picture.

Comparable uncontrolled price (CUP). A price arrived at in a truly comparable unrelated sale most accurately reflects an arm's length price. Examples include (1) sales made by the company to unrelated customers, (2) purchases made by the company from unrelated sellers, and (3) sales made between other unrelated parties.

Resale price method. The buyer's resale price is reduced by an appropriate mark-up percentage. This method is most appropriate when a distributor does not add significant value to the property by physically altering it or by employing significant intangibles in the resale.

Cost plus method. Under this method, the seller's cost of production is determined and an appropriate mark-up (gross profit) percentage is added to that figure. This method is appropriate when a manufacturer sells products to a related entity which performs substantial manufacturing, assembly or other processing of the product or adds significant value by use of intangible property prior to resale in uncontrolled transactions.

Berry ratio. The Berry ratio is the ratio of the gross margin to operating expenses. If the Berry ratio for a company with related-party transactions is similar to the Berry ratio for comparable companies, then the company is deemed to have met the arm's length pricing standard. The Berry ratio is likely to be unreliable when the amount of capital required per dollar of sales varies among the companies being compared.

Return on capital method. This method compares the return a company earns on its capital (e.g., total assets) to the return on capital earned by similarly situated independent companies. This method treats all intercompany transactions in an integrated fashion rather than separately. This method may be particularly well suited for companies which have complex intercompany transactions for which no comparable uncontrolled prices exist. It is not well suited if a company has significant intangibles.

Profit split. Under this method one determines how the overall profit from intercompany transactions is split between the related companies and then determines whether this split appears reasonable in light of each company's contribution to the transaction.

To Dr. Enn Roose
From Emil Sunley

Tax Holidays

Many countries have used special tax concessions, income tax holidays in particular, to attract investment from both foreign and domestic sources and to channel it into priority areas of development. Tax incentives for special purposes, that is those that target specific industries or activities, have come under heavy criticism in the recent tax policy literature for several important reasons.

1. Special tax incentives generally serve multiple goals. As economic conditions change, necessary amendments add layers of complexity. Despite efforts to simplify them, they remain difficult for taxpayers to understand, difficult to administer, and are frequently subject to political manipulation.

2. Special tax incentives are a costly means of achieving economic objectives. If the incentives are small, the economic gains are usually limited. If they are large, they typically cause serious erosion of the tax base.

3. Despite sometimes prodigious legislative efforts to the contrary, special tax incentives are by nature inequitable and economically inefficient. They create effective tax rates that vary both between and within sectors, and thus misallocate capital stock. They also create the impression of discrimination against certain industries.

4. Income tax holidays, in particular, constitute an inefficient method of promoting investment in new enterprises, which are typically unprofitable in the early years and thus unlikely to benefit. The principal beneficiaries are more likely to be enterprises that are profitable from the outset and might not have needed incentives.

5. As a partial response to the above criticism, some countries, including Estonia, have provided that the tax holiday does not start until the first year in which profits are earned. Under this regime, companies have an incentive to arrange their tax affairs so as to zero out their taxable income as long as possible, saving the tax holiday period until later. Tax auditors are unlikely to make any significant adjustments to the tax accounts if the effect of the adjustment is to trigger the tax holiday period and not to generate immediate tax revenue.

6. A final, frequently cited concern about tax holidays relates to their ineffectiveness in attracting foreign investment from countries that tax corporate income earned abroad, but give tax credits for income taxes paid in the host country (notably the U.S.). Unless the host country negotiates a "tax sparing" agreement with the foreign taxing authority (under which tax

credits awarded by the host country are creditable), the tax incentives have the effect of transferring tax revenues from the host country to the home country of the firm, and the company derives little or no benefit from the tax holiday.

In recognition of the defects of special targeted tax concessions, and in consonance with the worldwide trend toward expanded tax bases and lower tax rates among developing countries, several developing countries have recently executed tax reforms in which special incentives were eliminated and general tax rates for businesses were reduced. Notably, recent tax reforms in Indonesia, Colombia, and Malawi eliminated most special tax incentives in favor of a broader tax base and lower general tax rates on businesses.

In Estonia were to repeal the special tax holiday rules, Estonia may want to enact liberal depreciation rules as an incentive for investment in depreciable property, especially machinery and equipment and to enact a net operating loss carryover to help start up companies. Also, the repeal of the tax holiday rules should not be retroactive. Companies that have invested in Estonia during the period the tax holiday was in effect should be grandfathered, that is, they should continue to benefit from the tax holiday. In addition, companies that have made a binding commitment to invest but have not yet done so should also be grandfathered.

A Survey of Foreign Investment Policies of Selected Developing Countries

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Purpose of Report

This document is a survey of foreign investment policies in developing countries, focusing primarily on restrictions on foreign investment. We have selected countries which have attempted to protect vital industries while encouraging investment or which have achieved impressive economic growth in recent years. This survey is meant to stimulate discussion of the best way to maximize foreign investment while controlling resources in the national interest.

Chile

Date of source
February 1984

Government attitude toward foreign investment
The government of Chile actively seeks foreign investment as a means of economic development. Chile withdrew from the Andean common market to escape restrictions on foreign investment.

Foreign exchange controls
Regulation of foreign exchange is the responsibility of the central bank of Chile. Capital can be brought into Chile in foreign currency. However, foreign exchange operations are to be effected through authorized banks and financial institutions.

Investment registration
A contract with the Foreign Investment Committee specifying a time period for implementing the investment must be signed.

Repatriation
Foreign investors may remit profits annually. Capital may be repatriated 3 years after entering the country.

Restricted industries
All forms of business activity are open to foreign investors.

Restrictions on foreign ownership
None.

Other restrictions
Investments are to be implemented within 3 years of registration, except for mining investments, which are to be enacted within 8 years of registering the investment.

Restrictions on land use and ownership
None.

Cites
The Foreign Investment Statute, Decree Law 600 (1977) as modified by Decree Law 1748. Supreme Decree 1272.

Greece

Date of source
December 1988

Government attitude toward foreign investment
The government encourages investments in heavy and export-oriented industries.

Foreign exchange controls
An application must be filed with the Bank of Greece to engage in foreign exchange transactions.

Investment registration
Foreign investors must register investments with the Ministry of National Economy with a feasibility study showing the benefits to the local economy. Foreign investors who are EC residents must register under presidential decree 207, which allows free movement of capital between Greece and other EC states.

Repatriation
Foreign investors must obtain government approval to ensure repatriation rights. Repatriation of proceeds from liquidation of investments by non-European Economic Community (EEC) residents is not allowed until three years after the initial investment. Full repatriation is allowed for ECC members.

Restricted industries
The government operates monopolies for the production and distribution of matches and salt. The government also has exclusive control and ownership of Olympic Airways, OTE (telecommunications), ELTA (post office) , DEI (electricity production and distribution), ERT1 and 2 (radio and television networks), OSE (railways) and the Greek sugar company.

Restrictions on foreign ownership
Greek banks must be locally owned except that some foreign ownership is allowed in certain specialized shipping or export banks. Foreign ownership of Greek shipping companies cannot exceed 49%. A majority of the members of the board of directors of Greek insurance companies must be Greek citizens. Mutual funds cannot be administered by foreign companies. Foreign ownership of Greek mining companies requires government approval. Foreign individuals of non-EEC origin cannot own shares in real estate corporations.

Other restrictions
None.

Restrictions on land use and ownership
None.

Cites
Laws 2687 (1953), 1262 (1982), Presidential Decree 207 (1987) and Bank of Greece Decision 825 (1986-87)

Comments
As explained above, distinctions exist between treatment of ECC and non-ECC investors in regulation of foreign investment.

Hong Kong

Date of source
April 1986 and 1991

Government attitude toward foreign investment
Hong Kong welcomes foreign investment, but does not offer tax holidays and other incentives.

Foreign exchange controls
Hong Kong has no exchange controls and no restrictions on holding foreign currencies. Exchange control regulations were abolished in 1972.

Investment registration
Public companies incorporated outside of Hong Kong must submit a certificate of incorporation and other related documents.

Repatriation
Investment income may be transferred without restriction, and capital can be repatriated.

Restricted industries
The postal system, water supply, harbor, airport, Kowloon-Canton railroad and Radio-television Hong Kong are directly controlled by the government. These enterprises are closed to domestic or foreign private investment.

Restrictions on foreign ownership
The government makes no distinction between local and foreign companies. There are no regulations pertaining to foreign ownership of businesses operating in Hong Kong.

Other restrictions
None.

Restrictions on land use and ownership
Nationality does not affect an investor's ability to purchase real estate. Because the government owns virtually all land in Hong Kong, most land is leased for 75 years with the option to renew the lease. Leases are not granted for periods beyond 1997, the termination date of the lease of Hong Kong from China to Great Britain under the 1989 Convention of Peking.

Indonesia

Date of source
September 1986

Government attitude toward foreign investment
An investment promotion package was announced on May 6, 1986.
The government encourages private enterprise but requires local equity participation for foreign investments.

Foreign exchange controls
The central bank maintains a reporting requirement but no exchange controls.

Investment registration
The BKPM board reviews new investments. An investment priority list is published.

Repatriation
Repatriation of an investor's share capital is subject to government approval and is restricted until the investment is completed. Foreign Capital Investment Law 1 of 1967 regulates the transfer of foreign currency abroad.

Restricted industries
The refining, distribution and marketing of petroleum products are the only activities expressly closed to private investment.

Restrictions on foreign ownership
An investment may not exceed 30 years but can be renewed if certain requirements are met. A foreign investor must usually form a joint venture with at least one Indonesian partner. Initially 20% Indonesian ownership is required. Indonesian ownership of 5% is permitted if the enterprise is high risk, is capital intensive, involves high technology, is in a remote location or exports 85% of production. However, Indonesian ownership must reach 20% in 5 years, with an eventual transfer of 51% of the equity to indigenous Indonesians within 10 years. Similar requirements apply to the percentage of foreign managers. Foreign joint venture companies can gain rights enjoyed by domestic companies such as domestic distribution of production and the ability to borrow Indonesian currency from state banks. To qualify as a joint venture a company must sell 75% of the shares to the state or to private companies or sell 51% of the shares on the Indonesian stock market to Indonesian investors.

Other restrictions
None.

Restrictions on land use and ownership
Under the basic agrarian law of 1960 only Indonesian citizens can own land. Even if an investor can gain the use of land he must often develop access to roads, power, water and sewage lines.

Cites
Foreign Investment Law 1 (1967) and 11 (1970), Basic Agrarian Law of 1960

Korea

Date of source
July 1989 and 1991

Government attitude toward foreign investment
The government encourages foreign investment but is selective.

Foreign exchange controls
Stringent exchange controls are enforced.

Investment registration
All investments by foreigners require government approval. Investment in a Korean venture requires the approval of the Ministry of Finance under the Foreign Capital Inducement Law. Foreign corporations must register with the central bank. Approval is automatic through a one-stop service office except for stated exceptions. It is possible but unusual and difficult for foreigners to invest in a domestic Korean venture or to establish a Korean branch.

Repatriation
Repatriation requires approval.

Restricted industries
There are two state monopolies: tobacco and ginseng. Foreign investment is not allowed in public services such as provision of electricity, housing and water, export promotion, and farm development, all of which are provided by government-owned companies. The government maintains partial ownership in commercial banks, oil refining and heavy industries. About 80% of industry is open to foreign investment.

Restrictions on foreign ownership
In most cases, foreign ownership cannot exceed 50%. Exceptions are most likely if the firm introduces new technology or exports most of its production. The minimum value of foreign investment is US$100,000. The investment is not acceptable without review if it exceeds $US 300,000 for manufacturing and $US100,000 for non-manufacturing activities.

Restrictions on land use and ownership

Enterprises with majority foreign ownership may not own or lease land without the approval of the Ministry of Home Affairs.

Cites

Foreign Capital Inducement Law 1802 of 1966, amended by Law 2640 of 1973. Foreign Exchange Control Regulations Law 933 of 1961, amended by Law 1920 of 1967. Detailed guidelines on foreign investment promulgated by the Economic Planning Board.

Comments

Korea relaxed its restrictions on foreign investment after a period of economic stagnation during the 1970's and early 1980's. Amendments to the Foreign capital inducement law enacted since July of 1984 have expanded business areas open to foreign investment. Foreign exchange control regulations were relaxed in 1988 to allow remittance of annual profits subject to approval from a foreign exchange bank. A new policy stipulates that companies with foreign investment may be required to place shares on the Korean stock exchange after three years of operation.

Malaysia

Date of source
March 1985

Government attitude toward foreign investment
Investments from outside Malaysia, particularly in high technology, are welcome.

Foreign exchange controls
Exchange controls are administered by the central bank. Foreign companies are expected to borrow 50% of funds from domestic banks. Substantial domestic or foreign loans require approval.

Investment registration
Investments involving technology agreements require approval. All dealings with investors in Israel or South Africa require approval.

Repatriation
There are no repatriation restrictions, but a form must be filled out for information collection purposes.

Restricted industries
In the past, public utilities, telecommunications, railway transportation and postal services have been government owned. Feasibility studies are being conducted to determine if these industries could be operated by the private sector.

Restrictions on foreign ownership
The government feels that the need for foreign technology and capital must be balanced against the aspirations of Malaysians to participate in the economy. Therefore, foreign investment is welcomed in the form of joint ventures. All manufacturing companies with more than 25 employees must apply for a manufacturing license. A license is granted only after meeting local participation requirements. Companies in import substitution industries must have at least 70% Malaysian ownership. If an enterprise uses technology unavailable in Malaysia, foreign ownership of up to 49% is permitted. Export-oriented firms are allowed foreign ownership of 51 to 70 percent. On occasion companies that export 100% of production are permitted 100% foreign ownership. A maximum of 30% foreign ownership is stipulated for companies using nonrenewable domestic raw materials.

Other restrictions
None.

Restrictions on land use and ownership
None.

Cites
Industrial Concentration Act of 1975.

Mexico

Date of source
September 1991

Government attitude toward foreign investment
In 1989 the Mexican government established new rules to encourage foreign investment.

Foreign exchange controls
Foreign currency exchange controls were introduced in 1982. All export transactions must be made at a fixed exchange rate. Foreign currency, subject to availability, may be acquired at a market rate for any purpose including remittance of dividends to foreign stockholders.

Investment registration
Registration with the Ministry of Foreign Affairs, and sometimes with the National Commission of Foreign Investment, is mandatory for foreign investments in Mexico.

Repatriation
There are no restrictions on transferring payments in Mexican or foreign currency.

Restricted industries
Activities reserved exclusively for Mexicans include radio and television transmissions, transportation on federal highways, air and maritime transportation, use of forests, gas distribution and stockbroker or insurance services. In addition, certain activities are reserved only for the government. These include oil and gas production, nuclear energy, some mining, and supply of electricity, railroads, and telegraph services. The government is selling up to 70% of government-owned businesses to private concerns. If a company is on the verge of bankruptcy or requires foreign capital to stimulate exports, some of the above restrictions may not apply, for example in the petroleum or automotive industries.

Restrictions on foreign ownership
Foreign equity participation in unregulated industries is unlimited. For certain activities foreign investment is limited to 49% or less. These activities include telephone services, exploitation of national resources such as ores, minerals and sand, and manufacture of secondary petrochemical products, automobiles, explosives and machinery for electricity generation.

Other restrictions

Industrial establishments are to be placed outside of areas with high concentrations of population or industry. Companies must generate permanent employment and provide training to employees. Also, 10% of annual profits must be paid out to employees.

Restrictions on land use and ownership

Permission of the Ministry of Foreign Affairs is required to purchase real estate. A license is required from local authorities for any construction work. Additional restrictions apply for certain coastal or border zones in Mexico.

Cites

Law to Promote Mexican Investment and to Regulate Foreign Investment, 1973
Amendment to the 1973 Law, 1989

Comments

On May 16, 1989 a decree was issued that significantly liberalized the rules governing foreign investment in Mexico.

Philippines

Date of source
March 1989 and September 1990

Government attitude toward foreign investment
The government welcomes investments from abroad.

Foreign exchange controls
The central bank controls foreign exchange operations.

Investment registration
Foreign investment is regulated by the central bank, the Board of Investments and the Export Processing Zone Authority. Foreign investment requires registration with one of these agencies.

Repatriation
Repatriation of capital, profits and loans arising from technology transfer agreements requires central bank approval. Generally, full repatriation is allowed for export-oriented businesses. For other businesses, liquidation of investments is required before repatriation is permitted.

Restricted industries
There are no industries closed to private ownership. However, development and use of natural resources is permitted only under government supervision. Often, such enterprises are 40% government owned and 60% Filipino owned. Certain industries are closed to foreign investment. These industries include retail trade, some banks, use of natural resources, mass media, public works, the rice and corn industries, and most of the professions.

Restrictions on foreign ownership
Full foreign ownership is allowed for enterprises that export 70% of production, pioneer enterprises (which produce goods or use technology not already established in the Philippines), and for enterprises in specified export processing zones. Otherwise, maximum foreign ownership is 40%.

Other restrictions
None.

Restrictions on land use and ownership
Ownership of land is restricted to Filipino citizens, but foreigners can lease land. Businesses with at least 60% Filipino ownership can buy land. Foreigners can buy buildings on leased land.

Cites

Omnibus Investments Code of 1987.

Comments

Major changes have been enacted since the 1986 revolution.

Portugal

Date of source
March 1981

Government attitude toward foreign investment
Foreign investment is considered essential. The investor must show that the investment will benefit the economy.

Foreign exchange controls
The Bank of Portugal or the Institute of Foreign Investment must grant advance approval for foreign exchange transactions.

Investment registration
A direct investment permit must be filed with the Institute of Foreign Investment.

Repatriation
Repatriation is allowed but can be delayed by the central bank.

Restricted industries
Any large investment requires government approval. Industries closed to private investment include public utilities, transportation, port authorities, petroleum refining, fertilizers, munitions, and cement. The state holds title to all mineral and natural resources and will authorize their development only under special concessions.

Restrictions on foreign ownership
There are no foreign ownership restrictions in industries open to the private sector. The government encourages joint ventures, and negotiates the percentage of foreign ownership on a case-by case basis.

Other restrictions
Use of local labor and use of natural resources is subject to state approval.

Restrictions on land use and ownership
A nonresident corporation cannot directly acquire real estate.

Cites
Decree Laws 183 (1970), 348 (1977), 436 (1980), 46, 53, 54, 536 (1977) and 519-II (1979)

Singapore

Date of source
July 1988 and 1991

Government attitude toward foreign investment
The Singapore government actively encourages foreign investment.

Foreign exchange controls
Exchange controls were progressively relaxed and eventually eliminated in 1978.

Investment registration
There are no registration requirements for foreign investment.

Repatriation
Foreign investors are not restricted as to repatriation of capital, loans or income.

Restricted industries
The government maintains a monopoly in the manufacture of arms and ammunition. The supply of electricity, gas and water is also under public control.

Restrictions on foreign ownership
There are no rules on foreign ownership for businesses operating in Singapore, with the following exceptions. Licenses are required to undertake work in banking and insurance. Ownership of companies publishing newspapers is subject to legislative control.

Other restrictions
None.

Restrictions on land use and ownership
Approval is required to purchase certain types of residential property.

Comments
Businesses financed with foreign investment generally do not compete with local firms as they operate in different areas and markets.

Taiwan

Date of source
July 1989

Government attitude toward foreign investment
The government welcomes foreign investment. Recognizing that foreign companies introduce healthy competition into local markets, the government has removed many restrictions on foreign investment.

Foreign exchange controls
Foreign exchange transactions are processed through the central bank. Controls on inward remittances were imposed in 1987. Enterprises are not allowed to bring foreign exchange into Taiwan without central bank approval. Foreign exchange controls on outward remittances were greatly relaxed in July of 1987.

Investment registration
Foreign investors are required to submit an investment plan to the Ministry of Economic Affairs.

Repatriation
Subsequent to the 1987 relaxation of exchange controls, enterprises may remit payments of up to US$5 million per year.

Restricted industries
Although the range of businesses open to foreign investment has been broadened considerably, there are still 54 industries in which foreign investment is prohibited. In addition, there are 52 industries for which the government reviews each investment proposal.

Restrictions on foreign ownership
In some cases the government requires a certain percentage of local ownership, for example, security brokers and construction companies.

Other restrictions
Foreign investors are currently not permitted to invest in the local stock market.

Restrictions on land use and ownership
None.

Cites

Statutes for Foreign Exchange Control and Investment by Foreign Nationals. The legislation is often neither detailed or specific. Only appropriate authorities can provide interpretation.

Turkey

Date of source
August 1985

Government attitude toward foreign investment
A principal goal is to increase foreign exchange.

Foreign exchange controls
The physical import and export of Turkish currency is not allowed. Foreign-owned banks are required to conduct foreign currency transactions through the central bank.

Investment registration
Each foreign investment proposal requires a permit granted by the foreign investment department after a careful review of the investor's feasibility study. Import of foreign labor and resources is also examined. Approval is granted if it appears the proposal will increase foreign currency earnings, imports of foreign exchange, and industrial production.

Repatriation
Repatriation is allowed subject to the investment permit.

Restricted industries
Investments in manufacturing, agriculture, banking, mining and tourism are expected to be operated jointly with a Turkish partner. In certain cases the Turkish partner must be the appropriate state-owned enterprise. The total investment for a project is limited to $US 50 million. The minimum investment is $US 50 thousand. Exceptions are granted for large tourism projects which service foreign demand (for example large hotels). Mining licenses are granted for periods of 10 to 99 years. For manufacturing projects, at least 50% of the financing must come from abroad.

These ownership and investment restrictions also apply to the petroleum industry, but government approval is often granted more quickly. The state operates monopolies in tobacco and alcohol. To qualify for foreign investment in select industries a certain amount of production must be exported; food industry-30%, clothing-50%, furniture-60%, buses-40%, lorries-25%, metal goods-30%.

Restrictions on foreign ownership
Law 6224 covers investments in a wide range of manufacturing industries and in banking, agriculture, mining and tourism. Generally such investments will be

operated jointly with a Turkish partner with a foreign interest of 10 to 49 percent. However, this limit may be exceeded in appropriate circumstances.

Restrictions on land use and ownership
For tourist sites outside a city a special permit is required. Foreigners are permitted to lease government owned-land.

Other restrictions
None.

Cites
Laws 6224 with Decree 8/168, 6326, 1567 with Decree 30

Venezuela

Date of source
October 1984

Government attitude toward foreign investment
The government encourages foreign investment.

Foreign exchange controls
The central bank supplies foreign currency necessary for remitting capital and profits. Central bank approval is granted quickly and does not inhibit foreign investment.

Investment registration
New foreign investments require approval from the Superintendent of Foreign Investments. Investments specified in contracts with the government in tourism, construction and defense do not require registration. Foreign investments exceeding 20 million bolivars require special approval.

Repatriation
Profits may be remitted abroad up to 20% of the approved investment. Details must be submitted to the Superintendent of Foreign Investments.

Restricted industries
Certain activities are restricted to enterprises with at least 80% Venezuelan ownership. These industries include telecommunications, postal service, water and sewage, electricity, television and radio, newspapers, local transportation, the sale and marketing of goods, and licensed professional services in consulting and design. All activities related to petroleum or uranium are closed to private investment.

Restrictions on foreign ownership
None, but companies with less than 80% national ownership cannot enter certain industries specified above.

Other restrictions
A foreign investment must meet at least two of a list of conditions such as:
At least 30% Venezuelan content for products to be exported, job creation, introduction of technology, and investment in Venezuelan resources.

Restrictions on land use and ownership
None.

Cites

The investment rules fall under the Andean pact originally signed by Columbia, Chile, Peru, Ecuador and Bolivia. Venezuela joined in 1974.

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Deloitte & Touche,
A Review of the Investment Policy of the Republic of the Philippines

Price Waterhouse,
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Draft: April 10, 1992

Draft

of

Limited Liability Company Law

for

The Republic of Estonia

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Article One

Formation

§ 1

Purpose

(1) Companies with limited liability may be established by one or more persons pursuant to the provisions of this Law for any legally permissible purpose or purposes.

(2) In the event that a limited liability company is created by one person, then that person shall exercise all rights to which the shareholders meeting is entitled as in this Law provided.

§ 2

Form of the Articles of Association

(1) The articles of association shall be in [notarial] form. The articles shall be signed by all shareholders.

(2) Holders of a proxy may only sign the articles of association pursuant to a proxy certified by a [notary].

[It should be noted that a law on notarization is required. If it is not feasible to develop a notary profession as is customary in civil law nations, then the judicial system will have to be so developed to provide for document and signature certification.]

§ 3

Contents of the Articles of Association

(1) The articles of association shall contain:

1. the name and the principal place of business of the company;
2. the purpose(s) of the company, which may be general and all encompassing;
3. the amount of the total share capital;
4. the amount of the share capital to be initially paid in by each shareholder (the share capital contribution) and the number of shares to which each shareholder shall be entitled; and
5. the duration of the company if it is limited.

(2) If the duration of the company shall be limited to a specified period of time or if, in addition to any cash payment for the share capital contribution, non-cash contributions are to be made or other obligations are to be imposed on the shareholders, then these obligations shall be set forth in the articles of association.

§ 4

Name

(1) The shareholders are not restricted in selecting the name of the company.

(2) The name of the company shall in all cases contain the designation "with limited liability".

§ 5

Share Capital

(1) The total share capital of the company shall be at least _____ and, the share capital contribution of each shareholder shall be at least _____.

[Determination of minimum share capital should be considered in light of the low savings of Estonian citizens, the need to encourage new, even risky, business activities, the prospective currency reform and the possibility to amend this section.]

(2) Unless otherwise provided in the articles of association, a shareholder may subscribe separately for more than one share capital contribution.

(3) The amount of the share capital contribution may be different for each shareholder. The share capital contribution of all shareholders shall equal the total share capital and shall be evenly divisible by _____.

(4) If non-cash contributions are to be made by or obligations imposed on the shareholders (non-cash contributions), then the articles of association shall set forth the subject matter of the non-cash contribution and the amount of share capital contribution to be represented thereby. The shareholders shall set forth in a report the basis for determining the value of the non-cash contribution and, [in the event of a transfer of any business to the company], the financial statements of such business for the previous [2] fiscal years.

§ 6

Managing Board

(1) The company shall have a managing board consisting of one or more managing directors.

(2) Only a natural person with [unlimited] capacity to enter into legal transactions may be a managing director.

[Terms such as the bracket term are customarily defined in the civil code.]

(3) Shareholders or other persons may be appointed as managing directors. The appointments shall either be made in the articles of association or pursuant to a shareholders resolution.

§ 7

Registration

(1) An application for the registration of the company in the commercial register shall be filed with the [court in the district where the company has its principal place of business].

[Consideration should be given to using the Chamber of Commerce as the "home" of the commercial register. Germany is presently considering empowering the chamber to perform this function as the courts could not keep up with the demands. This will require a chamber law similar to that in several European countries, where a chamber is a public institution. Further from discussions and examination, it appears that the Estonian Chamber has or can achieve, the necessary capability.]

(2) The application may only be filed after at least one fourth of each share capital contribution to be in cash has been paid.

(3) At the time of the filing of the application of the company for registration in the commercial register, all non-cash contributions must be transferred to the company in such manner that they are at the unrestricted disposal of the managing directors and all other obligations must have been satisfied.

[Consideration should be given to establishing an administrative system to minimize the time gap between the satisfaction of the requirements in § 7 (2) and (3) and the filing to avoid potential legal difficulties. See § 13.]

§ 8

Application

(1) There shall be attached to the application:

1. the articles of association and, in the case of any proxy referred to in § 2(2), the proxies of the persons who have signed the articles of association or a [certified] copy of these documents;
2. a [certified] copy of the shareholders resolution appointing the managing directors unless they are appointed in the articles of association;
3. a list of the shareholders, signed by the managing directors, giving the names (business names), and domicile (or the address of the principal place of business) as well as the stated value of the share capital contribution of each shareholder, the number of shares to which each shareholder shall be entitled and a statement whether any shareholder or shares are entitled to any preference and the nature thereof;
4. in the case of any non-cash contribution or obligation, any agreement concerning the determination of the value of such contribution or obligation and the stockholder report referred to in § 5(4);
5. a [certified] copy of any regulatory permit in case any express purpose of the company requires a government permit prior to the commencement of business; and

[As indicated, the concepts of notarization and certification needs to be considered from a practical point of view.]

(2) The application shall contain an affirmation by the managing directors that, with respect to the share capital contributions, the provisions of § 7(2) and (3) have been complied with.

(3) The application shall state the extent and manner of the authority of the managing directors to represent the company.

(4) A document containing the specimen signatures of each member of the managing board shall have been filed with [the court in the district where the company has it principal place of business].

§ 9

Claims of the Company for Compensation

(1) If any statement in the application for the formation of the company is incorrect, then the shareholders and the managing directors shall be jointly and severally obligated to make any contribution which is missing and otherwise shall be liable for any damage caused.

(2) Any claim under § 9 is barred five years after the date of the registration of the company in the commercial register or the act giving rise to the liability, if the act was committed subsequent thereto.

§ 10

Compromise

A waiver or compromise entered into by the company with respect to any claim for damages arising pursuant to § 9 is invalid to the extent it is necessary to satisfy the claims of creditors of the company. This shall not apply if the person liable to pay such compensation is insolvent and makes a compromise with his creditors in order to avoid or terminate bankruptcy proceedings.

11

Denial of Registration

If a company was not properly formed or the application was not properly made, then the [court] shall deny the registration of a company.

§ 12

Filing in the Commercial Register

(1) The filing in the commercial register shall state the name and the principal place of business of the company, the purpose(s) of the company, the amount of the total share capital, including a description of any non-cash contribution, the date of the adoption of the articles of association, and the names of the managing directors. In addition the extent of the authority of the managing directors shall be recorded in the commercial register.

(2) If the articles of association contain any limitation on the duration of the company, then this shall also be recorded.

§ 13

Legal Status Prior to Registration

(1) The company with limited liability acquires legal existence upon its registration in the commercial register.

(2) Any person who acts in the name of the company prior to its registration in the commercial register is personally and severally liable.

Article Two

Legal Relations of the Company and of the Shareholders

§ 14

Nature of the Limited Liability Company

(1) A company with limited liability has its own rights and may assume its own obligations, sue and be sued.

(2) Only a company's assets are available for the satisfaction of the liabilities of a company to its creditors.

(3) A company under this Law is deemed a commercial company within the meaning of the [commercial code.]

[As noted basic legal concepts are defined in the civil code or the commercial code. Consequently the drafts of all of these codes must be coordinated.]

§ 15

Shares

The share capital of the company is divided into shares of equal or unequal value. If a shareholder may have more than one share, then all the shares forming the share capital of the company should be equal and indivisible. The articles of association may assign shares of

the company different rights and obligations. The articles of association may also assign to any shareholder special or personal rights or privileges.

§ 16

Transfer of Shares

(1) Unless the articles of association otherwise provide, shares of a company are transferable and inheritable.

(2) If the articles of association restrict or exclude the heirs of a deceased shareholder from inheriting such shareholder's shares, then the articles of association must set forth the terms of compensating such heirs; otherwise the restriction or exclusion shall be ineffective.

(3) If a legal entity, which holds a share in a company, is wound-up and liquidated, its shares shall be transferred to its legal successor unless otherwise provided in the articles of association. In such case, the terms of compensating such successor must be set forth in the articles of association; otherwise any restriction or exclusion shall be ineffective.

(4) Shares which a shareholder acquires in addition to his original share or shares remain separate shares.

(5) Any transfer, including a pledge, of a share is required to be in a [notarized] writing.

(6) An agreement creating an obligation of a shareholder to transfer his share must be in writing.

(7) The articles of association may make the transfer of shares conditional on the company's consent being obtained, or it may restrict it in another way.

§ 17

Notice of Transfer

(1) In the case of any transfer of a share, the transferor or the transferee shall notify the company about the transfer and shall present to the company evidence of such transfer, including the [notarized] writing referred to in § 16(3). The transfer of a share shall become effective and shall be recognized by the company only from and after the company receives such notice of the transfer.

(2) Prior to receipt of the notice of transfer by the company, the company may consider the transferor as the shareholder for all purposes; and the transferor shall retain all rights and obligations of a shareholder. The transferee shall be bound by all actions occurring prior to such receipt by the company.

(3) The transferee is jointly and severally liable with the transferor for any unpaid obligation in respect of a share outstanding at the time of the receipt by the company of the notice of transfer.

§ 18

Transfer of Part of a Share

(1) The transfer of part of a share, including by inheritance, may only be made with the consent of the company or as otherwise permitted in this Law.

(2) Any consent of the company must be in writing. It shall identify the transferee and the amount of the share capital contribution, as represented by the undivided share, allocated to each of the shares created upon the split.

(3) The articles of association may provide that the transfer of part of a share to other shareholders or the splitting of shares of deceased shareholders among their heirs does not require the consent of the company.

(4) The provisions of § 5(1) and (3) shall apply in respect of the transfer of part of a share or the splitting of shares.

§ 19

Joint Ownership of a Share

(1) If two or more persons own a share jointly, then they may only exercise their rights jointly.

(2) Joint shareholders are jointly and severally liable to the company for any obligations in respect of the share.

(3) Any action which the company may undertake in respect of a holder of a share is valid even if the action is only in respect of one of the joint holders unless a designated representative of the joint holders has been appointed and the company has received evidence of such appointment. The foregoing provision shall apply with respect to the heirs of any shareholder only after one month has elapsed from the date of [inheritance].

[The concept of inheritance must be defined in the applicable section of the civil law.]

§ 20

Payment of Share Capital Contribution

(1) Payments in respect of any share capital contributions are to be made by the shareholders in proportion to their interest in the share capital. However the articles of association may provide that the company may issue a share for an amount in excess of the

stated amount of the share capital contribution. This surplus or excess payment is not part of the share capital and shall be recorded in the financial statements of the company as part of the capital reserves.

(2) Except in the case of a decrease in the share capital, shareholders can not be released from their agreement as set forth in their subscription. Shareholders cannot claim a right of set-off in making any such payment. There is no right of retention in respect of the subject matter of a non-cash contribution for claims which have no relation thereto.

(3) A contribution in respect of the share capital contribution which does not consist of cash does not release the shareholder of his obligation unless it is made in accordance with § 5(4).

§ 21

Default Interest

A shareholder who does not timely make any share capital contribution shall pay to the company default interest at the rate prescribed by law.

§ 22

Exclusion of Defaulting Shareholders

(1) In the event of any default by a shareholder in making any payment, the company shall send to the defaulting shareholder a letter requesting payment within a specified

period and stating that unless payment is made, the defaulting shareholder's shares, in respect of which payment is sought, shall be forfeited. Such request shall be sent by registered letter. Such specified period shall be not less than one month.

(2) If the requested payment is not made prior to the expiration of such period, the defaulting shareholder's shares, in respect of which payment is sought, and any partial payments previously made in respect thereof shall be immediately forfeited in favor of the company. The declaration of forfeiture shall be sent to the defaulting shareholder by registered letter.

(3) The defaulting shareholder shall be and remain liable to the company for any loss incurred by the company with respect to any arrears in payment or to any amounts of the share capital contribution which were subsequently called (defaulted amount).

§ 23

Liability of Predecessors

(1) Each and every predecessor of a defaulting shareholder, of which the company has received notification as herein required, is liable to the company for the amount of the defaulted amount not paid by the defaulting shareholder.

(2) A predecessor of the defaulting shareholder is only liable if the defaulted amount is not made by the immediate successor to such predecessor. In the absence of evidence to the contrary, such non-payment shall be assumed if such immediate successor has not made

such payment within one month after a request for payment was sent to him by the company and after such predecessor was notified of such request.

(3) The liability of a predecessor to make any payment in respect of the share capital contribution is limited to a period of five years. The period begins on the date the company received notification of the assignment or transfer of the shares as in this Law required.

(4) A predecessor shall acquire the shares of a defaulting shareholder upon payment of all defaulted amounts.

§ 24

Forced Sale of a Share

If the payment of any defaulted amount cannot be obtained from the predecessors of the defaulting shareholder, then the company may sell the shares by public auction or private sale for such price as the company may agree upon.

§ 25

Liability for Arrears

To the extent that any defaulted amount cannot be collected from the persons obligated to make such payments and can not be covered by the sale of the share as in § 24 set forth,

the remaining shareholders shall pay the defaulted amount in proportion to their shares unless the shareholders determine to reduce the share capital of the company as in this Law provided, but in no event less than the amount set forth in § 5(1) and in compliance with § 66. If any shareholder fails to pay such amount, then the remaining shareholders shall pay such amount in proportion to their shares.

§ 26

Mandatory Provisions

A shareholder cannot be released from the obligations set forth in § 22 to 25.

§ 27

Supplementary Contributions

(1) The articles of association may provide that shareholders may resolve to call upon the shareholders to make payments in addition to the amount of the share capital contribution (supplementary contribution).

(2) Supplementary contributions shall be paid by each shareholder in proportion to its shareholding.

(3) The articles of association may limit the obligation to make supplementary contributions to a fixed amount, which is an amount to be made by the shareholders in proportion to their shareholding.

§ 28

Unlimited Obligation to pay Supplementary Contribution

(1) If the obligation to make supplementary contributions is not limited to a fixed amount, then unless the articles of association provide otherwise, each shareholder, provided he has fully paid his share capital contribution, shall be entitled to be released from making any supplementary contribution by offering his shares to the company within one month after the date of the call for such supplementary contribution. The company may, by registered letter, declare that it considers the shares of a shareholder as having been so offered if the shareholder neither exercises such right nor makes the supplementary contribution within the prescribed period.

(2) Unless the articles of association provide otherwise, a company shall have the right to sell such shares, after a shareholder has made such offer or the company has made such a declaration, by public auction or by private sale for such price as the company may agree upon. The proceeds of the sale, less the costs of the sale and the amount of any supplementary contribution, shall be paid to the shareholder.

(3) Unless the articles of association provide otherwise, if the company cannot recover an amount sufficient to cover the costs of the sale and the amount of the supplementary contribution, then the company shall become the owner of the shares. Thereafter the company shall be entitled to sell the shares for its own account.

§ 29

Limited Obligation to Pay Supplementary Contributions

(1) In the event that the obligation to pay any supplementary contribution is limited to a fixed amount, then the provisions of § 22 to 24 relating to the payment of the share capital contribution apply also in case of a delay in the payment of any supplementary contribution provided that the articles of association do not provide otherwise. This shall also apply in the case of an unlimited obligation to pay supplementary contributions to the extent that such supplementary contribution does not exceed any amount determined in the articles of association.

(2) The articles of association may provide that a call for the payment of supplementary contributions to which the provisions of § 22 to 24 apply may be made before the share capital contributions are fully paid-up.

§ 30

Distribution of Earnings

(1) The shareholders are entitled to receive the annual net earnings as determined in annual financial statements, unless statutory law or the articles of association determine otherwise.

(2) In the shareholder resolution on profit allocation, the shareholders may transfer certain amounts to profit reserves or carry them forward as profit unless the articles of association provide otherwise.

(3) The distribution of annual net earnings shall be made in proportion to the shares held. The articles of association may determine a different standard of distribution.

[It should be noted that this section must be revised in compliance with EC directives when Estonian accounting standards are established or appropriate provisions to cover such directives must be inserted in the commercial code].

§ 31

Repayments

(1) The assets of the company required for the preservation of the share capital may not be paid out or otherwise distributed to the shareholders.

(2) Supplementary contributions that have been paid may be repaid to the shareholders unless they are required to meet a loss of the share capital or unless the share capital has not been fully paid. The repayment shall not be made before the expiration of three months after the resolution on the repayment was announced [in the publication provided for publications concerning the commercial register]. Supplementary contributions which have been repaid are deemed as not having been called.

[It should be noted that a publication requirement has been included in the circumstances set forth in § 31 but not in all circumstances which a West European country has come to expect. First it is unclear whether any Estonian paper has sufficient circulation or status to satisfy the concept of notification via publication. Secondly this concept can be easily covered in the commercial law.]

§ 32

Refund of Prohibited Payments to the Company

(1) Any payment made in violation of the provisions of § 31 shall be refunded to the company.

(2) In the event that a refund cannot be obtained from a recipient within one month after the request therefore has been made by the company, then the remaining shareholders are liable for the payment of such amount in proportion to their shares. The amount to be refunded which cannot be obtained from a shareholder within one month after

the request therefore has been made by the company shall be paid proportionally by the remaining shareholders.

(3) Any person obligated to pay any amount pursuant to § 32 can not be released from such obligation.

(4) A claim of the company is barred after five years. The period of limitation begins with the expiration of the day on which the payment of the amount to be refunded has been made by the company.

(5) The managing directors who have acted negligently or are otherwise at fault for the making of a payment in violation of the provisions of § 31 are jointly and severally liable to the shareholders for the refund of any payment made by such shareholders pursuant to § 32.

§ 33

Repayment of Dividends

Except as provided in § 32(1), a shareholder shall have no obligation to repay any amount which he may have received as a dividend.

[Certain additional sections concerning payments which were made when a reasonable and prudent businessperson would not have made such a payment because of the probable

bankruptcy of the company, need to be considered upon the adoption of a bankruptcy code and Estonian accounting standards. Such matters can be included in the commercial code.]

§ 34

Acquisition of Own Shares

(1) The company may not acquire or take as security its own shares for which the share capital contributions have not been fully paid.

(2) The company may acquire its own shares for which the share capital contributions have been fully paid, provided the cost of acquiring the shares can be paid out of assets exceeding the share capital and it complies with any reserve requirements set forth in the [commercial code] or as provided in the articles of association.

§ 35

Redemption

(1) The redemption or amortization of shares may only be effected to the extent provided in the articles of association.

(2) Without the consent of the holder of the shares to be redeemed, a redemption of shares may only be effected in accordance with the provisions of the articles of association

as in effect prior to the date the holder acquired the shares or pursuant to an amendment of the articles of association approved by the shareholder.

(3) The provisions of § 31 (1) are not affected by the provisions of this section.

Article Three

Representation and Management

§ 36

Representation by the Managing Directors

(1) The company is represented by its managing directors in and out of court.

(2) The managing directors shall act in accordance with the provisions of the articles of association. Unless otherwise provided in the articles of association, all managing directors shall act jointly on behalf of the company. If any instrument with legal effect is submitted to the company, addressing or submitting it to one of the managing directors will suffice.

(3) Any person signing on behalf of the company shall sign beneath the name of the company.

§ 37

Business Letters

(1) All letters to third parties must set forth the principal place of business of the company, the court of register and the number under which the company has been entered in the commercial register. If a statement is made in respect of the share capital of the company, then the amount of share capital must be stated as well as the aggregate amount of any unpaid subscriptions.

(2) The statements pursuant to § 37(1) are not required in communications which are given within an on-going business relationship and for which forms are customarily used.

(3) Purchase orders are deemed to constitute letters within the meaning of § 34(1).

§ 38

Effect of Managing Directors' Representation

A company is bound by legal transactions performed or entered into in the company's name by its managing directors; it is irrelevant whether or not a transaction is expressly performed in the name of the company or whether, under the circumstances and in accordance with the intention of the parties, it was to be performed on behalf of the company.

§ 39

Limitation of the Managing Directors' Authority

(1) The managing directors are under an obligation to the company to keep within the limitations of their authority as set forth in the articles of association and the resolutions of the shareholders.

(2) Any limitation on the authority of the managing directors to represent a company is without legal effect in respect of third persons. In amplification of the foregoing, this applies in case the representation is limited to certain business or kinds of business or shall be conducted only under certain circumstances or for a specified period of time or at specified locations or to cases in which the consent of the shareholders or other management body of the company is required.

§ 40

Revocation of the Appointment of the Managing Directors

(1) The appointment of a person as a managing director may be revoked at any time, notwithstanding any claims for compensation by a managing director arising from any existing contract.

(2) The articles of association may limit the scope of a revocation. If the scope is limited to "for cause" situations, material violation of duties or the inability or failure to engage in sound management practices shall be considered as "for cause" grounds.

[the concept "for cause" needs to be further defined in the commercial code or in a future commentary on the law.]

§ 41

Registration of Managing Directors

(1) Every change of a managing director, as well as the termination of the authority of a managing director to represent the company, shall be filed in the commercial register.

(2) There shall be attached to the application, setting forth the matters referred to in § 41(1), to the court referred to in § 7(1), the original or [certified] copy of documents in respect of the appointment of a managing director or in respect of the termination of the authority of a managing director to represent the company.

(3) A document containing the specimen signatures of each new managing director shall be filed with such court.

§ 42

List of Shareholders

Each year during the month of January, the managing directors shall file in the commercial register, a list of shareholders, including their main professions (if any) and address of their domiciles or principal place of business, and the amount of their share capital contributions. To the extent that no change has occurred since the last list was filed, an appropriate statement to that effect will suffice.

§ 43

Bookkeeping

The managing directors are obligated to ensure that the company keeps proper books, records and accounts.

§ 44

Balance Sheet

(1) In the annual balance sheet included in the annual financial accounts to be prepared in accordance with the requirements of the [commercial code], the share capital shall be shown as subscribed capital.

(2) The right of a company to call for the making of supplementary contributions by its shareholders shall be shown in the balance sheet as an asset to the extent that a resolution to call such a contribution has been adopted. The shareholders are not entitled to be released from the obligation to make such a contribution by offering their shares as in this Law otherwise permitted. Any contribution still to be made is to be shown separately on the asset side of the balance sheet among the receivables under the heading "supplementary contribution called". An amount equivalent to such an asset should be shown on the liability side of the balance sheet under the heading "capital reserve".

(3) Loans, receivables and other amounts payable to shareholders shall be shown separately as such or in the annex of notes; it must be disclosed if any such item is included elsewhere.

[The accounting terms and concepts herein set forth must correspond to those used in the new accounting principles to be adopted in Estonia.]

§ 45

Submission of Annual Financial
and
Business Reports

(1) The managing directors shall submit to the shareholders annual financial accounts and company business reports promptly after their preparation in order to permit the shareholders to review and approve the accounts and reports. If the annual accounts are to be audited, the managing directors shall submit to the shareholders, the accounts and reports,

together with the audit report, promptly after the audit report has been received by the company. If the company has a supervisory board, the report of the supervising board must also be promptly submitted to the shareholders.

(2) The shareholders must, within six months after receipt of the accounts and reports or, if earlier, by [December 31] of the year in which the accounts and reports were received, conclude their review of the accounts and reports, adopt a resolution thereon, whether or not with reservations, and allocate any profits. The articles of association may not provide for a longer period.

[This should be coordinated with any tax law filing requirements. The timing provisions should be flexible but nevertheless establish timing standards.]

(3) If the annual accounts are to be audited, the auditor, upon the request of a shareholder, must participate in the discussions relating to any review of the annual accounts.

(4) If the company has to prepare consolidated annual accounts or a group business report, the provisions of paragraph 1 shall apply accordingly with the provison that no separate review with respect to the consolidated annual accounts is required.

§ 46

Managing Directors: Standard of Conduct and Liability

(1) Managing directors shall conduct the affairs of the company in the manner of a prudent businessperson.

[The concept of what constitutes such a prudent businessperson needs to be defined in the Estonian context. Consideration should be given to developing a law commentary system as customary in several European countries so that legal interpretations of difficult concepts become easier. Of course the interpretation and experience of the country upon which a law is based can be used as persuasive interpretative authority.]

(2) Unless the articles of association, or a shareholders' resolution, provide otherwise, a managing director may not:

(a) conclude business transactions in his own name or for his own account to the extent such transactions are associated with business activities of the company;

(b) mediate or broker transactions with the company for other persons;

(c) engage directly or indirectly through one or more legal entities in business activities similar to that engaged in by the Company.

(3) Managing directors who violated their obligations are jointly and severally liable to the company for any damage resulting from such violation, including the payment of any profit made from a prohibited business transaction or the transfer to the company of the rights ensuing from such a transaction.

(4) In amplification of the provisions of § 46(2), managing directors shall be liable for any damages if, in violation of the provisions of § 31, payments are made from the assets of the company which are necessary for the preservation of the company's share capital, or if, in violation of the provisions of § 34, the company's shares are acquired. The provisions of § 10 shall apply in respect of any claim for damages. If compensation is necessary to satisfy the claims of creditors of the company, the liability of the managing directors is not excused by the fact that they have acted in compliance with a resolution of the shareholders.

(5) Any claims pursuant to the provisions of § 46 are barred after five years.

§ 47

Loans to Certain Persons

No loan may be granted to any managing director, other legal representative of the company, a prokurist or a holder of a power of attorney out of the assets of the company which are necessary for the preservation of the share capital of the company. Any loan granted in violation of the foregoing provisions of this § 47 must be repaid immediately, irrespective of any agreement to the contrary.

§ 48

Deputies of the Managing Directors

The provisions applicable to the managing directors shall apply also to any deputies of

the managing directors.

§ 49

Rights of the Shareholders

(1) The rights of shareholders of a company, including any special or personal rights which may be granted any shareholder, shall be set forth in the articles of association, subject to compliance with the provisions of statutory law.

(2) Except as otherwise set forth in the articles of association, the provisions of § 50 to 55 shall apply. The articles of association may also include such other provisions, which are not in conflict with the provisions hereof, as the shareholders may approve.

§ 50

Competence of the Shareholders

(1) The following matters shall be subject to shareholder action:

1. the review of actions taken on behalf of the company prior to the incorporation of the company;
2. the shareholders may reserve the right to decide on matters otherwise falling within the authority of other company bodies;

3. the approval and amendment of the articles of association.

4. the review and approval of the annual financial statements and the distribution and appropriation of any profits;

5. the call for payments in respect of share capital contributions;

6. the authorization of an increase or reduction of the share capital;

7. the repayment of supplementary contributions;

8. the splitting and the redemption of shares;

9. the appointment and the removal of managing directors and the termination of any of their responsibilities;

10. the rules and regulations applicable to the supervision of the management of the company;

11. the appointment of prokurists and grant of a power of attorney to any person;

12. the assertion of any claim for damages against any managing director or shareholder;

13. the representation of the company in any suit with any managing director or member of the supervisory board;

14. such other matters as in this Law specifically provided.

§ 51

Voting

(1) Shareholders shall adopt resolutions by majority vote, except as in this Law otherwise provided.

(2) Each _____ of a share shall entitle a shareholder to one vote.

(3) Proxies must be in writing.

(4) The shareholders may for cause discharge another shareholder from his responsibilities or release him from his obligations or liabilities by the adoption of a resolution. The shareholders may also adopt a resolution concerning the conclusion of a transaction with a shareholder or the institution or termination of a lawsuit with a shareholder. The shareholder who is the subject of any such resolution may not participate in the voting on such resolution.

[The term "for cause" should be defined in the articles of association.]

§ 52

Shareholders' Meeting

(1) Shareholder resolutions shall be adopted at a meeting or by written consent.

(2) The articles of association shall establish quorum requirements for a shareholder meeting.

(3) Resolutions may be passed without a meeting if shareholders representing such number of votes as may be necessary to adopt the resolution as provided in the articles of association agree in writing to the adoption of the resolution; provided, all shareholders shall have been provided with drafts of such proposed resolutions for their review and comments

with a specified period. Unless a shareholder comments on the draft within the specified period, it shall be registered that he agrees.

§ 53

Call of the Meetings

(1) Shareholders' meeting may be called by the managing directors or as otherwise provided in this Law.

(2) A meeting of shareholders shall be called by the managing directors promptly if the annual balance sheet, or any balance sheet prepared during the fiscal year, shows a loss of [half] or more of the share capital.

[This provision should be re-considered after the bankruptcy code is completed as bankruptcy concepts in this Law and in the bankruptcy code must be co-ordinated.]

§ 54

Minority Rights

(1) Shareholders representing at least one - tenth of the share capital are entitled to request that the managing director call a meeting by stating the purpose and the reasons therefore.

(2) If the managing directors do not comply with such request within three weeks after receipt thereof, then the requesting shareholders may themselves call the meeting. The shareholders shall adopt a resolution at such meeting as to whether the costs of convening and holding the meeting are to be borne by the company or the shareholders calling the meeting. Any resolution proposed by such shareholders shall be included in the notice of the meeting.

§ 55

Notice

(1) A notice of the meeting shall be given by registered mail not less than [two] weeks prior to the date of the meeting.

[Consideration should be given to what type of notice is practical in Estonia and the length of time necessary to deliver a notice.]

(2) The matters to be considered at a meeting shall be set forth in the notice of the meeting.

(3) If a meeting is not properly called, then no resolution may be adopted at the meeting unless all the shareholders are present at the meeting.

56

Shareholder Right to Information

(1) The managing directors shall inform without undue delay any shareholder, after receipt of a written request about the conduct of the business of the company and permit him to inspect the company's books and records.

(2) The managing directors may refuse to provide such information and to permit such inspection if there is reason to fear that the shareholder will use it for purposes other than the business of the company and the shareholder will thereby cause not immaterial harm to the company or one of its affiliates.

(3) Any refusal to provide information or permit an inspection requires the adoption of a shareholder resolution. This provision cannot be changed by the articles of association.

57

Judicial Determination

With respect to a judicial determination regarding the right to information and inspection, _____ of the [commercial code/joint stock company act] shall apply. Any shareholder who has not been given the requested information or permission to inspect shall be entitled to file an action with the court.

[Since certain standard procedural rules are normally established for the different types of companies, this should be further considered jointly with the drafters of the joint stock company law.]

§ 58

Supervisory Board

(1) If pursuant to the articles of association, a supervisory board shall be appointed, then _____ of the [commercial code/stock corporation law] shall apply unless the articles of association provide otherwise.

[See comments above in §57]

(2) If the members of the supervisory board are appointed before the registration of the company in the commercial register, _____ of the [stock corporation law] shall apply. The managing directors shall publish immediately every subsequent or successor appointment in the court referred to in §7(1).

(3) Any claim for damages against a member of the supervisory board for violation of his duties is barred after five years.

Article Four

Amendments of the Articles of Association

§ 59

Amendments

(1) The articles of association may only be amended by a shareholders' resolution adopted by not less than two-thirds of the votes cast. The articles of association may also establish additional requirements, including a higher vote requirement.

(2) The resolution shall be certified by a [notary].

(3) Unless otherwise provided in the articles of association, an increase in the share capital contribution required to be made by a shareholder requires the consent of that shareholder.

§ 60

Registration

(1) An amendment of the articles of association requires an application with the court referred to in §7(1) and the filing of the amendment in the commercial register to be accompanied by a certification of the managing directors and the shareholders who approved the amendment in accordance with § 59(1).

(2) Unless the amendments relate to a matter set forth in § 12 (1) and (2), it is sufficient that the registration in the commercial register only refers to the amendments as filed with the court referred to in § 7(1).

(3) An amendment of the articles of association is of no legal effect prior to the registration thereof in the commercial register.

§ 61

Increase of Share Capital

(1) If the share capital of a company cannot be increased in accordance with the existing provisions of the articles of association, then the share capital can only be increased by an amendment of the articles of association.

(2) Unless otherwise provided in the articles of association or the shareholders' resolution increasing the share capital, the existing shareholders shall have priority to acquire the increased share capital in proportion to their existing shares. This right of prior purchase must be exercised within one month of receipt of written notice thereof by the submission to the company of a subscription as in this § 61 provided. The managing directors shall send out written notices thereof to all shareholders at the same time.

(3) The company may also sell shares of the increased share capital to persons who are not already shareholders. Such prospective shareholder shall submit a subscription thereafter to the company as in this § 61 provided.

(4) Each subscription, whether by an existing shareholder or a new shareholder, shall be in writing, which shall be [certified], and shall set forth the amount of the capital share contribution of the subscriber. The subscription by a new shareholder shall also state the amount of any additional contribution to which the new shareholder shall be obligated pursuant to the articles of association and that he is becoming a shareholder in accordance with the articles of association.

(5) If an existing shareholder subscribes to a share of the increased share capital, then he acquires an additional share or as otherwise determined pursuant to the provisions of this Law.

(6) The provisions of § 5(1) and (2) shall also apply with respect to the acquisition of the increased share capital.

(7) In addition to increasing the share capital of a company by the sale of shares as in § 61(2) - (5) provided, the shareholders may determine to increase a company's share capital from its existing property. In such as case, the amount of each shareholder's share capital contribution shall be deemed proportionately increased.

§ 62

Non-Cash Contributions

(1) If a non-cash contribution is to be made, then the shareholder resolution concerning the increase of the share capital shall describe the non-cash contribution or obligation imposed and determine the amount of the share capital contribution to which the non-cash contribution relates. The description shall be included in the subscription referred to in § 61(4).

(2) The provisions of § 9 shall apply.

§ 63

Contribution of the Increased Share Capital

With respect to the making of the share capital contribution of the increased share capital, the provisions of § 7(2) shall apply.

§ 64

Registration

(1) The application for filing in the commercial register the increased share capital shall be made after the entire amount thereof is fully covered by subscriptions of existing or new shareholders.

(2) The application shall state that the contributions in respect of the increased share capital have been made in accordance with § 7(2) and that any non-cash contribution is at the disposal of the managing directors and that all other obligations imposed have been satisfied.

(3) There shall be attached to the application:

1. the subscriptions referred to in § 61 or a [certified] copy of them;
2. a list of the persons who have subscribed to the increased capital share, which is signed by each such person unless the original subscription was included pursuant to § 64(2); the list shall show the amount of the increased capital share to which each of them has subscribed;
3. In the event of share capital increase for non-cash contributions, the applicable agreements, or certified copies of them, which constitute the basis for the determination pursuant to § 62 or which have been made in performance thereof.

(4) With respect to the liability of the managing directors who have applied for the registration of the share capital increase in the commercial register, § 9 and § 46 shall apply.

§ 65

Denial of Registration

With respect to the denial of the registration by the court, § 11 shall apply.

§ 66

Decrease of the Share Capital

(1) A decrease of the share capital may only be made in accordance with the following provisions:

1. the shareholders resolution authorizing the decrease of the share capital shall be published by the managing directors at least three times in a publication permitted pursuant to § 31. These publications shall call upon creditors of the company to voice their objections in writing within three months from the date of the last publication. The announcements may not be made more than once per month or less than two weeks apart; the creditors who are shown in the records of the company or are otherwise known to the company shall be notified directly.
2. creditors who voice their objections and do not consent to the decrease shall be satisfied or security for their asserted claims shall be provided; creditors who do not voice their written objections are deemed to have consented to the decrease in the share capital.
3. an application to file the resolution authorizing the decrease shall not be filed in the commercial register before three months have expired since the date of the last publication.
4. the publication of the shareholder resolution shall be submitted together with the application; at the same time the managing directors shall state that the

creditors who have voiced an objection and did not consent to the decrease have been satisfied or secured.

(2) The provisions of § 66 shall not apply if the share capital is decreased and simultaneously increased to the original amount either by increasing the value of existing shares or by issuing new ones.

(3) Notwithstanding any decrease in share capital, the provision of § 5(1) concerning the minimum amount of the share capital shall remain unaffected.

Article Five

Dissolution and Invalidity of the Company

§ 67

Voluntary Dissolution

(1) A company shall be dissolved:

1. upon the expiration of the period of time, if any, set forth in the articles of association;
2. by a resolution of the shareholders, unless otherwise determined in the articles of association, by a majority of three fourths of the votes cast;
3. by a decree issued pursuant to § 68;

4. by the institution of bankruptcy proceedings; if the proceedings are terminated after conclusion of a compulsory settlement or are terminated upon motion of the debtor in bankruptcy, then the shareholders may decide to continue the company;

5. upon the order of the court of registry which has determined that there is a defect in the articles of association, which defect was not cured within three months after the court has issued an order to the company to have such defect cured.

(2) The articles of association may set forth other reasons for the dissolution of the company.

§ 68

A Company's Winding-up without Dissolution

(1) Should a company determine to the wound up voluntarily, it may be simultaneously decided that it shall be transformed into another form of a company or shall be taken over, merged or divided. This shall not affect any other restrictions required by law.

(2) In the event of a company's transformation, the then existing company shall be wound up without dissolution if on the day of submitting a petition asking for the dissolution of the existing company, all the prerequisites for the establishment of its successor entity (entities) are met. A petition asking the establishment of a successor entity (entities) into the

commercial register must be submitted simultaneously with the petition asking to delete the dissolving company.

The court referred to in § 7(1) shall delete the dissolving company from the commercial register and incorporate its successor entity (entities) on the same day. Should the prerequisites for the establishment of a successor entity (entities) not be met, then the dissolving company shall be subject to dissolution as in this Law provided. In the event of a dissolving company's transformation into a new entity, all the assets of the dissolving company shall be transferred to its successor entity.

(3) In the event of a merger, assets of the dissolving companies shall be transferred to its successor company or their successor entity which result from said merger. In the event of a takeover, the assets of the dissolving company shall be transferred to that entity, which takes over the dissolving company.

(4) In the event of a division of the dissolving company, its assets shall be transferred to its successor, namely the newly established entities. Each of the new entities, which have come into being on the basis of said division, shall be liable for the obligations which have been transferred to them from the dissolving company, up to the amount of the net assets, which have been transferred from the dissolving company. Should the resolution on dividing the company not stipulate to which successor entity a certain obligation is transferred, all the successor entities shall be liable to fill such an obligation jointly and

severally. These entities shall then settle the claim between them in the ratio in which the net assets of the dissolved company have been transferred to them.

(5) The deletion of a dissolving company (companies) and the establishment of a successor entity (entities) coming from either the merger of the companies, or the company's division, shall be filed in the commercial register on the same day. The deletion of a dissolving company, which is taken over, as well as a amendment in the commercial register filing of the entity, which takes over the dissolving company, shall also be made on the same day.

(6) Each of a shareholder's investments in a dissolving company shall be deemed to be investments of the same amount into the new entity (entities), unless the resolution concerning the dissolving company stipulates otherwise.

§ 69

Dissolution by Administrative Action

(1) If the shareholders or a supervising board knowingly permit the managing directors to violate the law, then the company may be dissolved by the competent authorities without a claim for any compensation arising therefrom.

(2) The procedure and the competence of the governmental ministries and departments shall be governed by the provisions of the [administrative] law in force with respect to administrative litigation.

[The competent authorities, as well as the procedures for dissolution, must be set forth in the appropriate administrative law.]

§ 70

Obligation to File a Bankruptcy Petition

(1) If a company becomes insolvent, then the managing directors shall file a petition for the institution of bankruptcy proceedings or for the institution of judicial composition proceedings without undue delay, but in any event not later than three weeks from the date on which the insolvency occurred. The foregoing obligation shall also apply if the assets of a company no longer exceed its liabilities. It will not be considered as an undue delay if the managing directors pursue the institution of the judicial composition proceedings with the diligence of a prudent businessman.

[The concept of prudent (or reasonable) must be established in the commercial law.]

(2) The managing directors shall be liable to the company for the restitution of any payments made after the insolvency of the company has occurred or after its excessive indebtedness has been ascertained. This does not apply to any such payments which would have been made by a prudent businessman. The provisions of § 46 shall also apply.

[The bankruptcy code must be coordinated with these provisions.]

§ 71

Registration of the Dissolution

(1) An application by the managing directors shall be filed for the registration of the dissolution of the company in the commercial register. This shall not apply in the case of dissolution as a result of bankruptcy proceedings or a judicial determination of a defect in the articles of association. In these cases the court shall register the dissolution and the reason for it ex officio.

(2) The dissolution shall be published by the liquidators at least three times in the publication indicated in the [bankruptcy law]. Such publication shall request the creditors of the company to notify the liquidators in writing.

[Consideration should be given to have one law set forth the provisions on publication in all the different and varying instances.]

§ 72

Liquidators

(1) In the case of dissolution, except in the case of bankruptcy proceedings, the liquidation shall be carried out by the managing directors, unless otherwise provided in the articles of association or a resolution of the shareholders.

(2) Upon motion of shareholders who hold shares representing not less than one - tenth of the share capital, the appointment of liquidators may be made by the court referred to in § 7(1) if cause for a court appointment exists.

(3) A court may remove liquidators appointed by it for cause. A liquidator who has not been appointed by the court may also be removed by a resolution of the shareholders before the expiration of the period for which he has been appointed.

§ 73

Registration of the Liquidators

(1) A statement naming the initial liquidators and setting forth their authority to represent the company shall be filed in the commercial register by the managing directors and each change of a liquidator or any change in their authority shall be made by the liquidators filing a statement in the commercial register.

(2) There shall be attached to the statement the documents concerning the appointment or change of any liquidator or a [certified] copy thereof.

(3) The registration of the judicial appointment or removal of the liquidators shall be made ex officio.

(4) The liquidators shall file with the court a document containing their signatures.

§ 74

Representation by the Liquidators

(1) The liquidators shall represent the company in the manner determined at the date of their appointment. In the absence of any such determination, the liquidators shall act jointly on behalf of the company. If any instrument with legal effect is submitted to the company, addressing or submitting it to one of the liquidators will suffice.

(2) Any liquidator signing on behalf of the company shall sign beneath the name of the company which shall be identified as being "in liquidation".

§ 75

Legal Relations of the Company and its Shareholders

(1) Notwithstanding the dissolution of the company, the provisions of the Articles Two and Three relating to the rights and obligations of the company and of its shareholders shall apply until the termination of the liquidation, subject to the provisions of this present Article and the requirements for effecting the liquidation.

(2) The court having jurisdiction over the company at the date of its dissolution shall remain competent until all of the assets of the company have been distributed.

§ 76

Duties of the Liquidators

The liquidators shall terminate the business of the company and shall discharge its obligations, collect its accounts receivable and convert the assets of the company into cash. The liquidators shall represent the company in and out of court. In order to terminate the business of the company, the liquidators may also enter into new transactions.

§ 77

Balance Sheet. Rights and Duties

(1) The liquidators shall prepare a balance sheet as of the date of commencement of the liquidation period (opening balance sheet) and a report commenting on such balance sheet as well as an annual financial and business report as of the end of each year thereafter.

(2) The shareholders shall review and approve the opening balance sheet and the subsequent annual reports and may the discharge the liquidators from their responsibilities. The principles referred to in § 44 governing the preparation of the annual financial reports shall apply to the opening balance sheet and the corresponding report as well as the subsequent annual reports.

Fixed assets shall be valued in the same way as current assets if they are to be sold within a reasonable period of time and are no longer used in the business.

(3) The [court] may grant an exemption from the requirement to have the annual reports and the corresponding business reports audited, provided it is not necessary to satisfy the interests of the creditors and the shareholders. The decision of the [court] is subject to immediate appeal.

[Consideration should be given to how administratively to effect the necessary professionalism in the courts or other agency to make such determination.]

(4) In other respects the liquidators shall have the rights and obligations of managing directors under § 38, § 39, § 43, § 46, § 53 and § 71.

(5) All business letters shall comply with the provisions of § 37 and shall indicate that the company is in the state of dissolution.

§ 78

Distribution of the Assets

The assets of the company shall be distributed among the shareholders in proportion to their shares. The articles of association may determine a different proportion for the distribution.

§ 79

Protection of Creditors

(1) A distribution shall not be made before the debts of the company are discharged or secured and in any event not before the expiration of one year after the date of the third publication of the notification to the creditors under § 71(2).

(2) If a creditor known to the company does not file a claim, then the amount due shall be deposited for the account of the creditor in a bank in a dedicated account. If any liability can not be discharged or if a liability is contested, then a distribution of the assets of the company may only be made if the applicable creditor is given security.

(3) Liquidators who act in violation of these provisions are jointly and severely liable for the repayment of any amounts distributed. The provisions of § 46(4) and (5) shall apply.

§ 80

Books and Records

(1) After the termination of the liquidation, the books and records of the company shall be deposited with one of the shareholders or with a third person for a period of ten years. In the absence of a provision in the articles of association or of a shareholders'

resolution, the shareholder or the third person shall be determined by the court referred to in § 7(1).

(2) The shareholders and their legal successors are entitled to inspect the books and records of the company. Creditors of the company may be authorized by the court referred to in § 7(1) to inspect them.

Article Six

Final Provisions

§ 81

Persons Authorized to file Applications with the Commercial Register

Any commercial register application provided for in this Law shall be filed by the managing directors or the liquidators. However filings or applications provided for in § 7, §61(1) and § 66(1) no. 3, shall be made by all managing directors.

§ 82

Administrative Penalties

The provisions of _____ of the [commercial code] concerning filings with the commercial registry shall remain unaffected.

[The commercial code should set forth general or basic obligations concerning the making of filings.]

§ 83

False Statements

(1) A prison term of up to _____ years or a fine shall be imposed on a person who makes false statements:

1. as shareholder or as managing director, in the registration of the company, concerning the subscription to the share capital contributions or obligations, the making of share capital contributions, the use made of contributions paid in, concerning special share privileges, formation expenditures, non-cash contributions and security for any contribution in cash not fully paid;
2. as managing director, liquidator, member of a supervisory board or a similar body in a published statement misrepresents or conceals the business condition of a company provided such act is not punishable in the [commercial code].
3. as managing director, in the registration of the increase of share capital, concerning the subscription to, or payment of, increased share capital or with respect to non-cash contributions or the satisfaction of any obligation;
4. as managing director in the confirmation to be given pursuant to § 8(3) or § 41, or as liquidator in the assurance to be given pursuant to § 73.

(2) The same penalty shall be imposed upon a person who:

1. as managing director makes a false statement with respect to the satisfaction or the security of the creditors for the purpose of effecting a decrease in the share capital; or

2. as managing director, liquidator, member of a supervisory board or a similar body, makes a false or misleading statement regarding the financial situation of the company in a communication to the public.

§84

Violation of Obligations in Case of Loss, Insolvency, Excess Indebtedness

(1) A prison term of up to _____ years or a fine shall be imposed upon a person who:

1. as managing director fails to notify the shareholders of a loss in the amount equal to [half] or more of the share capital; or

2. as managing director contrary to [§70] or as liquidator contrary to § 77(4), fails to file a petition for the institution of bankruptcy proceedings or of judicial composition proceedings in the event of insolvency or of excess indebtedness.

§ 85

Violation of Confidentiality Requirement

(1) A prison term of up to ____ year or a fine shall be imposed on a person who discloses, without authority, a secret of the company, particularly a trade or business secret, which has become known to him in his capacity as managing director, member of the supervisory board or liquidator.

(2) If a person acts for payment, or with the intent to enrich himself or someone else, or to damage someone else, the penalty shall be a prison term of up to ____ years or a fine. Any person who utilizes, without authority, a secret of the type referred to in paragraph 1, particularly a trade or business secret, which became known to him under the circumstances of paragraph 1, shall be subject to the same penalty.

(3) Proceedings to institute criminal action shall only be the responsibility of the supervisory board, or if no supervisory board exists, with special representatives appointed by the shareholders. If the criminal act was committed by a member of the supervisory board, the right to petition shall be the responsibility of the managing directors or the liquidators.

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Deloitte & Touche

Republic of Estonia

Phase II Report

Volume 3

In Association With:
Development Alternatives, Inc.
Geonomics Institute
Milbank, Tweed, Hadley & McCloy
Multinational Strategies, Inc.

Delivery Order No. 7
Project No. 180-0014
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Eastern Europe Enterprise Restructuring and Privatization Project

U.S. Agency for International Development
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May 15, 1992

Deloitte Touche Tohmatsu International

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Volume 3

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Annex B: Sample Edition of Congressional Record and
Annex C: Sample Edition of Federal Register (1 volume)

In Association with:
Development Alternatives, Inc.

The Restructuring of the Estonian Electronics Industry

Submitted to:

Department of Foreign Economic Relations
and
The Ministry of Industry

Republic of Estonia

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APPENDIX: Individual enterprises visited

The Restructuring of the Estonian Electronics Industry

Executive summary

Deloitte & Touche and DAI are pleased to submit this report to the United States Agency for International Development (AID). The report consists of recommendations for privatization, the economics of privatization, a survey of enterprises in the electronics industry in Estonia, the characteristics of the industry, and a plan for future privatization activities.

John Brown of Deloitte & Touche and Daniel Hogan of DAI compiled this report, following field visits from 20-31 January, 18-27 February and 3-9 April, 1992. They were assisted by Ms. Viive Uus, translator. Government of Estonia sponsorship for the project resided in the Department of Foreign Economic Relations and the Ministry of Industry; enterprise visits were sponsored by the Estonian Electronics Union and the Estonian Electronics Association, with assistance from the Estonian Academy of Sciences.

The entire range of electronics enterprises within Estonia was visited, consisting of small, medium and large scale manufacturers of diverse products either directly or indirectly related to the production of electronic goods with consumer, military, industrial, scientific and research applications.

In general, though certain exceptions exist, the enterprises surveyed share the characteristics of heavy Soviet industry: outputs dictated by central planning authorities in Moscow, heavy reliance on the former Soviet Union for raw materials, technology and markets, little or no financial accountability, management and production efficiencies regulated by output quota, intense vertical integration and limited contact with Western counterparts.

Indeed, it may be misleading to think of this report as being limited to the electronics industry. First, the enterprises visited were much more varied than would usually be considered electronics in the United States. Second, the critical characteristics that repeated themselves in virtually all the large enterprises were those of an enterprise functioning under a Soviet style central plan. The recommendations here are likely to be relevant well beyond the electronics industry.

The assets of the surveyed enterprises, including property, plant, equipment, ancillary assets and technology are owned by the Government of Estonia, following Estonia's declaration of

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independence from the former Soviet Union in August, 1991. Considerable legal reform will be required to resolve conflicting ownership claims, as well as to create the ability to transfer ownership in the future. Several enterprises are operating presently as quasi-autonomous entities under lease arrangements with the Ministry of Industry; others have made few, if any, changes, to their legal status, simply becoming responsible to the Estonian Ministry of Industry, rather than to a Soviet Ministry. However, legal status aside, most former All-Union enterprises remain dependent upon the former Soviet system for production inputs, finance and sales. Several entrepreneurial enterprises were also examined, which were start-ups by local technically qualified individuals within certain product niches. All of the electronics enterprises lack adequate working capital, find raw materials scarce or unavailable, lack managerial experience and have little, if any, access to domestic, regional or foreign markets for their goods.

The industry, taken as a whole, appears to be unstable. Production cutbacks, layoffs, curtailment of procurement and dwindling inventories are typical. With the evaporation of demand from the former Soviet Union, few new markets have been discovered. Capital investment is at a standstill, with no access to local or offshore commercial credit. Physical plant is inappropriate, outdated and in poor repair. Equipment appears to be outdated, having been purchased from Soviet or Warsaw Pact sources, with routine maintenance and replacement largely ignored. Technology lags anywhere from 5 to 40 years, depending upon the type of production facility.

Significant and widespread engineering skill exists among a well-trained cadre of engineers, inventors and scientists. Often difficult production obstacles are overcome routinely through application of little more than raw talent. There is little reason to doubt that the human resources in place are capable of performing well when combined with the right tools, technology and materials.

The products surveyed are included in an appendix to this report, without technical evaluation, which is beyond the scope of this project. It is clear, however, that most of the products surveyed do not now meet Western product certification standards, nor have they been tested for quality and tolerance specifications applicable in the West.

Recommendations for an enterprise by enterprise approach to privatization are included in this report. The recommended approach is to restructure enterprises into smaller firms, organized typically along technological lines. These firms should be transferred immediately to private hands, typically those of current managers and employees in exchange for promises to share future profits with the government for a limited period. This approach

avoids the need for valuation of the assets prior to transfer, and does not require financing of the transfer. Instead, the government exchanges the assets for a limited claim against future profits.

Recommendations

1. The Government of Estonia should begin restructuring the large enterprises of the electronics industry into a number of small and medium sized firms.

The current Estonian electronics enterprises bear closer resemblance to a viliage than to a modern international electronics enterprise. Foreign well-capitalized investors are likely to be uninterested in buying a jumble of what appear to them to be unrelated assets -- the village -- instead of the one or two streamlined product lines that interest them.

2. The fault lines within the enterprises used for breakup should be along the borders of different technologies.

For example, tool and die making should be separated from metal working. That in turn should be separated from plastic injection molding, and the design and manufacture of printed circuit boards. Further separation should be made from the working of silicon into circuits and their assembly into chips. All these operations should be separated from the ownership of real estate. The maintenance of buildings and other ancillary assets, such as apartment buildings and other social assets should also be separated.

Many of the separated small firms, such as metal working, while not necessarily interesting to foreign investment, are likely to have a real role in developing the general internal capability of Estonian industry. Overall, the restructuring of these enterprises will contribute significantly to the development of a vigorous small and medium sized business segment in Estonia.

After a restructuring, there would be a significant number of small competing tool and die makers, for example, that have come out of these large electronics enterprises. Certainly there is currently excess capacity in tool and die making within the enterprises.

These small firms would be enabled to, and would have to, enter the Estonian marketplace to offer their goods and services to a wider marketplace. They would start to provide competitive tool and die making to the entire Estonian marketplace. Some would fail and some would survive, depending on their skills and the overall demand for their services in Estonia. In the process, the management involved would start to focus on filling the needs of the market rather than simply obeying the commands of the general director of the current enterprise.

If left in large enterprises, these small firms would become part of the larger failure of the enterprise. Any potential contribution to Estonia by these small firms would be lost.

3. The small firms that will be divested from the larger current enterprises should be offered to joint stock companies formed by the current management and workers within those technologies.

This is not intended to preclude firms being offered to joint stock companies formed by other interested investors or even by other combinations of workers and management. Where there is more than one party interested, the opportunities would be put up for bid in the manner discussed below.

4. Where appropriate or necessary, the small firms should be put up for bid to insure that they go to the highest bidder.

5. Since managers and workers in Estonia have virtually no access to capital, the bids should be denominated in percentage of profits that are earned for a period of several years.

Many of these firms will not be profitable: the assets that they have taken over are in fact worthless. The new owners should not have to pay the government to take over and operate what turn out to be liabilities rather than assets.

6. The period of years should be simple and not subject to manipulation. A fixed percentage might be used, such as 50%, of the years shown in the depreciation schedule used in the U.S. Internal Revenue Code for the depreciation of classes of assets for all assets older than half the depreciation age, and the full depreciation schedule for any newer assets.

I. Description of the Estonian electronics industry

The Estonian electronics industry is the largest single industrial employer in the country, with some 28,000 employees, which constitutes about 12% of the industrial work force. The thirteen largest enterprises employ 90% of the electronics work force, and account for some 95% of total electronics output. Total output of the sector was 525 million 1990 roubles. The industry is concentrated in Tallinn, with two significant sites in Tartu and two in Narva.

The industry grew substantially over the last several decades, governed by various Ministries within the former Soviet Union, directed, for the most part, by Soviet managers, utilizing imported Soviet workers. In the larger enterprises it was not unusual for ninety percent of the employees to be non-Estonian. There was little, if any, local influence or participation in the sector; indeed, much of it was secret, as many of the enterprises were directly linked to Soviet military industry.

Most electronics enterprises visited share the characteristics of heavy Soviet industry. Planned as what Marxists called "natural economies," the enterprises were completely vertically integrated,

requiring no support from the local economy. Production outputs were ordered by the Central Planning authorities of the Soviet Ministry which governed the particular enterprise, with little emphasis on the production of consumer goods. Rather, most technology was applied to Soviet military and defense establishment requirements. Raw materials, production guidelines, product standards and specifications, final product shipping and handling--all were handled by the respective Ministry. Thus, supplier relationships are virtually non-existent; in addition, most enterprises have little real knowledge of their ultimate customer. They relied instead on the orders placed through their Ministry as the means of reaching production goals. Marketing capacity, therefore, was never developed.

Financial accountability is lacking, as are standard balance sheets, profit and loss statements, inventory management techniques, tracking of accounts receivable and cash management. Again, the all-encompassing system of filling Ministerial requisitions replaced the management and production techniques normally associated with enterprises of this magnitude and technological capacity.

Raw materials, supplied virtually entirely from outside Estonia by the former Soviet Union, are characterized by poor quality, irregular technical specifications, erratic supply and, as of late, prices accelerating rapidly upward toward world market prices. Many enterprises are suffering currently from the inability to source raw materials, and have sharply curtailed production as a result. Most factory managers were not optimistic that their ability to purchase raw materials was to improve in the near term.

Physical plant is, for the most part, inappropriate, outdated and in poor repair. Many large enterprises are in nineteenth century multi-story factory buildings requiring production lines to be split among different floors of the same building. Floors are uneven, clean spaces are difficult to maintain, plumbing, heating and lighting are somewhat makeshift. An industrial park outside of Tallinn showed considerably more promise, with one story production facilities among the most modern to be found in Estonia.

For the most part, factory equipment is outdated, having been obtained from Soviet or Warsaw Pact sources, and with maintenance and replacement lagging. Most managers were able to state the average age of machinery in their plants; a typical response when asked was 10 years. Replacement parts have already become difficult to obtain from the former Soviet Union

Production methods are labor intensive, employing many more workers than would be typical in the West. It has been estimated by the Estonian Academy of Sciences that output per worker in the Electronics Industry is some 5 to 10 times lower than a similar

worker in the same industry in the West. There is little streamlining of production facilities; those operations most closely resembling assembly lines were operations in which units were hand-passed from one worker to the next.

Technology lags have been estimated at some 5 to 40 years, depending on the product line. One of the most advanced technologies in use is in the production of semiconductors; the plant manager estimated that the production facilities and products were some 7-10 years behind the West.

The variety of products is enormous: electronic components, complicated equipment and systems for industrial calibration, monitoring and measuring, aviation devices, semiconductors, certain medical equipment, integrated circuits, diodes, thyristors, pumps, compressors, engines, transformers and various analytical devices. See the Appendix for a list of the enterprises surveyed, their location and product lines.

The enterprises, at present, appear to be unstable. Certainly, external factors have contributed significantly to this destabilization. The loss of value of the rouble against convertible currencies, the diminished raw material supplies from the former Soviet Union and the end of demand for most military products are examples. However, the enterprises, even if restored to financial liquidity, with free access to raw materials, are positioned poorly to compete in the global marketplace, making Western investment implausible in the near future. Technological lags, lack of knowledge of the global electronics marketplace, lack of product certification according to Western tolerance and quality standards and the dearth of marketing skills cripple the sector's ability to promulgate Estonia as a viable, competitive market force in Electronics.

As is typical of the Soviet system, the Estonian electronics enterprises are replete with ancillary assets--those operating entities within the enterprises which provide services, housing, schooling, recreation, etc. but are not essential to the production facilities themselves. (Examples are: apartment buildings, catering services, musical groups, construction companies, fire departments, glass-blowers.) Distinct privatization methods need to be developed to separate these assets from the productive assets of the enterprises.

A. Three categories of enterprises

1. Large integrated enterprises

RET
Poogelmann
Elektrotehnika
Volta
Toostusaparaat
Tartu Aparaadiehitus Tehas

Tartu Kontrollaparatuuri Tehas
Eesti Kaabel
Baltijets

2. *Small Estonian entrepreneurial ventures*
Tallinna Elektrotehnika Institut
Shtamp
Tallinna Raadioelektroonika Konstrueerimisburoo
Various enterprises spun off from:
Estonian Academy of Sciences
Cybernetics Institute

3. *Retail and service enterprise*
Orbita Service

RET was identified as the leading candidate for restructuring for several reasons. They include its modern facilities, its potential for production for export, the borders between technologies are distinct, they have already been engaged in serious business planning, and their products have broad consumer appeal.

II. Restructuring the large integrated enterprises into smaller, coherent firms

A. The steps of restructuring

1. Identify the unit or units of the enterprise to be restructured

2. Identify possible buyers or stockholders

The likely buyers for any of the electronics enterprises or parts of enterprises are probably limited, at the present time, to current management and employees. However, it is possible that other unrelated parties, or even other configurations of managers and employees or suppliers and customers, might be interested in buying the firm. In that case, they should be encouraged to participate in the bidding process described below.

3. Valuation of the unit or of the assets that comprise the unit

While this is a normal part of restructuring firms in a Western context, or where there is a Western buyer, it will typically be inappropriate here.

The purpose of valuation is to assure the original owner of the assets that its management is getting proper rewards for the disposition of the assets and not too little, and, to assure the stockholders of the buyer that an appropriate price is being paid, and not too much.

The task of valuation is to identify a price at which a knowledgeable willing buyer would purchase the asset from a knowledgeable willing seller.

Traditional valuation techniques include historical costs of assets, current sale value of the assets, or projected cash flows that will be generated.

Historical costs are likely to be irrelevant to a knowledgeable buyer or seller because the costs were not arrived at using market values, and do not accurately reflect relative scarcity then or now.

Most assets surveyed in the electronics industry were not state of the art, and are not on the market in the world economy, except at something close to scrap value. However, in some cases there will be significant remaining value in the assets functioning in place until they are replaced by modern equipment in modern real estate.

Projections of future cash flows are extremely uncertain, because it is difficult predict with any reasonable degree of certainty what might flow from these assets. The amount of future cash flows depend critically on issues other than the assets: the effectiveness of management in a totally new environment, the ability of future owners to resell to higher bidders, the speed and completeness with which the government of Estonia will be able to resolve all the legal and legislative tasks necessary for a fully functioning market economy.

Because of all these uncertainties, it will usually be folly to invest significant funds into obtaining independent valuation of assets.

Privatization methods should be used that do not require the use of independent valuation of the assets, wherever possible.

4. Negotiate a price that will be acceptable to both parties

Current management and employees have no access to capital markets, so they are unable to borrow against future earnings of the firm. Lack of access to capital markets will severely limit the amount offered.

Still, when more than one party is interested in buying, some form of competitive bidding would be desirable to provide incentives to potential owners to reveal their estimate of the value of the assets.

5. Bidding structure

Since there is no effective access to capital markets for virtually all Estonians, the bidding should be in terms of a percentage of the profits to be earned, rather than cash.

The tenor of repayment to the government should be limited, so that the effects of the transition from socialism are strictly limited. The Government of Estonia should reserve the right to set a minimum bid.

An example of a method of limiting is to use half of the economic life of the relevant class of assets, as used by the U. S. Internal Revenue Service for tax purposes.

For example, a tool and die firm carved out of one of the electronics enterprises might be put up for bid, where the unit of bidding is percentages of profit for the next four years. Four years

would be applied by the government as half of the assumed IRS life for similar assets of 8 years.

Furthermore, if the assets that are provided in the privatization are resold outright, the Government of Estonia should receive a large percentage that declines over the expected life of the asset.

For example, if the same tool and die firm sold its tools and dies and presses in the second year of privatization, it should owe a large percentage of the value to the Government reflecting the depreciated value of the assets at the time of the privatization. However, if the assets were sold in the fifth year, we would assume that the assets were fully depreciated and the Government would get nothing.

6. Provide sales contracts to the firm with the enterprise or its successor firms, as a source of initial revenues

7. Negotiate a lease for the real estate

B. Payments to the Government of Estonia for the assets transferred to private parties

The Government of Estonia will be paid for transferring property, plant and equipment from two sources.

1. The result of the bidding process when a firm is profitable

New firms will pay a percentage of profits for the first few years if they are profitable in fact. The government will receive nothing from those firms that are not profitable.

2. The result of a resale of assets by a new firm

The government should get a percentage of any consideration received by a firm that has recently received assets under this program of restructuring. Here, the percentage should be declining over time, to reflect the diminishing role of the assets granted during the restructuring in the value of the firm.

C. Relationship of restructuring to attempts to attract foreign joint venture partners

1. Restructuring will typically make the firms more attractive to foreign or other well-capitalized investors than they are currently.

2. The restructuring will effectively clear out a great deal of underbrush from the perspective of the investor. Well-capitalized investors are not interested in taking responsibility for the extremely broad range of activities that these enterprises currently carry out in response to the needs of "natural economy." They may well see opportunities in assembling printed circuit boards, or building thyristors but are unlikely to be interested in becoming owners of tool and die making capabilities in Estonia at the same time. The restructuring would create a more attractive rebundling of the assets of the old enterprises.

3. Restructuring has the potential to greatly reduce the difficulty faced by foreign investors wishing to invest in Estonia. In order to begin

assembling printed circuit boards in Estonia, for example, after restructuring, a potential foreign investor or joint venture partner can simply negotiate directly and solely with the management of the restructured firm. The investor does not need to convince a large, unseen and unknown coalition of government and private people of the merits of proceeding.

D. Thoughts on Orbita Service

Currently, Orbita Service provides electronics retail sales and service throughout Estonia. It has entered the community television antenna business and plans to enter the cable TV industry.

One should think separately about the distribution functions and the retail functions performed by Orbita Service.

The retail and local service functions can probably be sold separately from the distribution which in turn can be sold separately from the cable and antenna business.

The separate retailers would probably want to retain a franchise relationship with the distributor, but the exact details of that relationship deserve significant further work.

E. Priorities for restructuring the large enterprises

There are many possible legitimate reasons for choosing one enterprise to restructure before another. They would include economic and social or political reasons as well as programmatic reasons. This report does not attempt to consider the social or political matters which may influence privatization decisions.

On the basis of the site visits and information received, the enterprises can be placed in the following groups, in order of priority.

a) The first project

RET

b) The second priority group

Poogelmann
Elektrotehnika
Volta
Baltijets
Orbita Service

c) The third priority group

PROMPRIBOR
Tartu Aparaadiehitus Tehas
Tartu Kontrollaparatuuri Tehas
Eesti Kaabel

III. The economics of privatization

A. Privatization is only a part of the transformation to an effective market economy

Currently Estonia is in the process of transformation from being part of a much larger centrally planned socialist economy to becoming an effective market economy integrated into the world economy, in a manner similar to other small Western countries open to international trade.

Estonia's primary economic goal is to achieve that transformation as quickly, effectively, and permanently as possible.

Effective market economies are constantly being transformed within the private sector. Firms are born and die, technologies are introduced and retired, skills are developed, rewarded, and made obsolete. Products and services are constantly being changed, both in terms of quality and price.

The central characteristics of an effective market are:

a) People are free to apply their skills and talents to their highest and best use;

b) People face incentives to put their assets to their highest and best use;

c) Consumers are sovereign, in that the economy is designed to respond competitively to their needs; and

d) There exists an enormously complex network of exchanges among private parties.

That network does not yet exist in Estonia, particularly in the electronics industry. All exchanges took place between individual enterprises and the center in Moscow. The center is now gone, and a totally different and much more complex web must replace the old one. Then, even if one segment of the web is lost, the stability of the network as a whole is not threatened.

There exists an even more complex web of knowledge about economic opportunities to buy, sell, and otherwise exchange. That web of knowledge is international in its scope. It is this knowledge of alternatives that allows one party to credibly demand that the other trading party act efficiently and competitively.

These networks cannot be provided by governments or by foreigners. They can only aid or impede the growth of these networks and webs of knowledge. The fastest way for a small and formerly isolated country like Estonia to develop such a web of knowledge is to expose people from every firm to foreign Western business and practice. For example, widespread attendance at international events like the Hannover Messe, a world class annual exposition in the electrical and electronics industry would be helpful.

Privatization is a critical part of that transformation to a market economy, but not the entire transformation. Privatization is the transfer of enterprises and assets from the government into private hands, and, more importantly, private control. Privatization is the initial step in moving assets and firms into the marketplace.

Privatization of an enterprise will be complete when the government has no more control over it. However, even in the most liberal western economies, the government retains a small role, through the enforcement of criminal, labor, tort and contract law, collection of taxes, and environmental regulation, for example.

After privatization, the firms will be able to freely enter into contracts with suppliers and customers to buy, sell, borrow and lend assets, products and services without obtaining permission from or even informing the government. Private parties will continue the ongoing process of change that is the market process, all in response to the needs of consumers and producers in Estonia and abroad.

Privatization must be done in a way that does not interfere with the further buying and selling, and combination of assets.

B. The range of possible privatizations

a) The do nothing option

The Government of Estonia continues to operate the enterprise. This option could be the result of delay, or of excess waiting for better alternatives, or of a political decision. This option is contrary to the fundamental interests of the government and people of Estonia. Further, it is a virtual guarantee of failure of the enterprise, since the enterprises are bound up in their history as part of the former Soviet Union, formerly under the direct control of ministries in Moscow, supplying far-flung parts of the now dissolved Union. No one would ever create such enterprises in such a manner and on such a scale today.

They will have to undergo major technical changes in scale, technology, organization and market in order to survive. The government is in no position to conceive, organize, finance or carry out such major changes. Many of these enterprises will fail, no matter what is done with them. The burden on them of inappropriate mission, structure, capital, plant, equipment, management, and skills of the work force all are overwhelming.

The social cost of complete failure of large enterprises is large. The cost of restructuring large enterprises is likely to be overcome by the economic and social savings resulting from survival of some of the new firms that are created, as compared to allowing all the employees of the entire enterprise to become unemployed.

The government's goal for enterprises that will fail should be to make that failure as limited in scope as possible, while salvaging any useful parts of the enterprise.

The worst outcome would be for failures to be seen as the fault of the current government of Estonia, rather than of the combination of the former Soviet Union and management.

b) Wait for purchase by well-capitalized buyers, typically foreign

This option in most cases would turn into the do nothing option, because for most enterprises it would be a long wait

indeed. For many of them in their current status, they are unattractive. Foreign companies are interested in firms that are strictly focused on specific production activities that are potentially profitable.

c) Turn over the enterprises in their present form to the managers and employees

Former Soviet enterprises are unfocused, like a village, and produce items that are likely to have to undergo major change if they are to have any chance in world competition.

Current management is unlikely to be able to manage such complex entities in an open trading environment. Like dinosaurs, these enterprises functioned in a particular environment where competition did not exist. The sole task of these enterprises was to supply the ministry with meters or wire or motors. Now, each part of the enterprise must shift its focus from the orders coming from the center in Moscow to opportunities that are available in a diverse marketplace, in Estonia and around the world. Nowhere else in the world are electronics manufactured in such enterprises; why should they succeed in Estonia?

d) Restructure the enterprises into several smaller firms and turn them over to the particular managers and employees

This is the alternative that is recommended and is discussed throughout the rest of the report.

e) Liquidation at auction of the individual assets of the enterprise

If the individual machines, tools, inventory and buildings were to be auctioned off in the equivalent of a liquidation, it is apparent that most of the items would be sold as scrap. There is probably little market for them and finding it would usually be more expensive than simply selling for scrap.

These assets instead have more value being kept in use, if possible, by the people who know how to use them.

1. Transaction costs

Transaction costs in Estonia today are effectively infinite for certain types of transactions that are important.

(1) Purchase and sale of firms, particularly firms that are large in the Estonian context
(2) Purchase and sale of assets
(3) International trade
(4) Trade in producer goods
(5) Borrowing and lending
(6) Purchase and sale or real estate
(7) Restructuring of firms

The causes of these transaction costs are the current lack of clear definitions of property rights that are provided by a property law, contract law, and a commercial code.

2. The central role of the current lack of knowledge

All parties today, no matter how sophisticated they may be in part of the issues surrounding the electronics industry, are largely ignorant about how the Estonian economy in general, or the electronics industry in particular, will be transformed on its way to becoming an effective market economy.

Therefore, restructuring should be understood to be only the first of a series of changes that firms will undergo in the transformation to an effective market economy.

The Government of Estonia's motives for privatization are:

Introduction of a market economy with its attendant economic efficiency;
An economic system consistent with democracy and political freedoms; and
Establishment of new sources of government revenues.

Certainly in the long term, the costs to the Government of Estonia will be lower by privatizing than not. Privatization becomes a permanent source of government revenues if the economy, through increased efficiency and higher productivity, moves to a growth pattern superior to that which existed prior to privatization, permitting the collection of taxes which are of increasing value.

IV. Technical assistance needs of existing small firms

A. During the course of the site visits for this report, several start-up firms, producing small quantities of niche electronics products, were investigated. These firms were often started by entrepreneurs with a technical background, and had strong links to the Estonian Academy of Sciences. Though dependent upon the Academy for initial investment costs, the firms operate independently, and are run as for-profit businesses.

B. The future development of the industry in Estonia goes well beyond the restructuring of the large, former Soviet enterprises, to include those smaller niche firms which are at the leading edge of technology changes. It is conceivable that a considerable part of the electronics industry in the future will consist of smaller firms, engaged in the following main fields of activities:

1. *manufacturing of sub products and components for larger firms;*
2. *final assembly and testing of products;*
3. *pilot production of high-tech products;*
4. *service and maintenance;*
5. *distribution and supply of materials and components.*

C. Assistance is required to enable these smaller firms to thrive. These firms would benefit from:

1. a program for the development of small and medium business managerial skills.

- Assist in establishing financial and cost accounting systems for the new firms in order to make financial accountability feasible;
- Assist new firms in preparing joint stock company documents
- Assist new firms in preparing a suitable business plan;
- Identify potential and actual environmental risks from existing and planned operations and allocate responsibility for them;
- Advise firm management on their tasks as managers of a new firm;
- Assess production methods, with recommendations for improvements;
- Advise on the legal structure and appropriate documentation .

2. availability of low cost technology parks, similar to those found in electronics areas around the world, where there are modern single story multi-purpose buildings, with appropriate research and development as well as production facilities;

3. a center for dissemination of market and technical information

4. an Estonian Bureau of Standards and Certification capable of testing products to world standards;

5. a modern taxation system that would encourage the formation of venture capital;

6. improved telecommunications for the sharing of rapidly changing technical information;

7. an identified personal computer based accounting software package, which, if properly used by the firms, will be adequate record-keeping for government accounting and taxation purposes as well as for private accounting;.

D. Employees, managers and owners of these small firms--many of them resembling technical think tanks with limited product output--have been isolated from mainstream technical advances. Receipt of scientific journals has been constrained, as has participation in trade fairs and scientific expositions, due to lack of funding. Personal contacts among outside industry counterparts have been negligible. It is critical that this be changed immediately. Electronics in the West is a huge undertaking where products, processes, and, therefore,

opportunities are changing constantly. Until Estonians are constantly meeting, reading, writing, and negotiating with their Western counterparts, it will be impossible for them to anticipate the best use of their scarce resources in such a rapidly changing world.

E. As the electronics privatization process unfolds, it is recommended that the Government of Estonia investigate the possibility of using funds raised from the sale of state electronics assets to foster the development of the smaller firms within the industry. Such funding could replace other government or Agency for International Development funding to support the exchange of scientific information, further educational exchanges, subscription to scientific journals, participation in conferences and symposia and visits to other electronics manufacturers in the West.

V. Restructuring action plan

The next steps are critical to creating small privately held firms from state enterprises.

Using RET as the first restructuring project, the next step should be the creation of a quick response team of local and foreign experts to define the precise contours of the restructured firms arising out of RET. This restructuring is intended to be a model for application to the particular facts facing other enterprises in the large All Union mold, both in and outside of the electronics industry. Due to the transferable nature of the model restructuring created here, later restructurings are likely to be simpler, after the initial model is developed.

This restructuring project will be done in close conjunction with the Ministry of Industry, the State Property Board, and the Department of Foreign Economic Relations. The transfer of assets or stock will be accomplished in a manner consistent with the then current legal structure. The more completely the body of law is modernized by the Parliament, the more appropriate will be the legal basis of the restructuring.

The first restructuring will be undertaken with the assistance of a combination of professionals drawn from a team of financial planners, attorneys, financial analysts, economists, industrial engineers, electronics technical specialists, and others as may be required.

To speed up the restructuring of other enterprises and provide continual access to restructuring services, the consortium will provide quick response teams to help the Estonian government take discrete acts to prepare for restructuring.other enterprises These teams would typically include a financial planner, an economist, a lawyer, a financial analyst and an engineer.

For each restructuring, the following areas of analysis, among others, should be carried out:

- Assist in the Estonian goverment in establishing simple financial and cost accounting systems that will be adequate for the new firms' financial accountability;
- Assist the Estonian government in preparing examples of the required joint stock company documents
- Advise on the legal structure and appropriate documentation .
- Identify potential and actual environmental risks from existing and planned operations and allocate responsibility for them.
- Assist the Government of Estonia to plan a strategy of providing existing and new firms with assistance in
  - Preparing a suitable business plan;
  - Advising firm management on their tasks as managers of a new firm;
  - Assessing production methods, and making recommendations for improvements

VI. Policy actions required for the long term effectiveness of privatization

A. Legal and legislative reforms are necessary for a successful transformation to an effective market economy

The Government of Estonia is aware of the significant obstacles to privatization posed by the lack of a coherent legal structure. The usual definitions of rights and obligations found in every market economy are currently lacking in Estonia. This report is not a legal one; the legal obstacles to privatization are highlighted as yet another example of the importance of the task of legal reform facing the Parliament and Ministries. It is clear that without legal reform Estonia will remain a second or third tier choice for private foreign investment even among the emerging economies of Central and Eastern Europe.

The centralization of economic decision making in Moscow has had a profound negative impact on the legal, regulatory and contractual framework within which individuals or firms operate. Little confidence exists that entering into economic arrangements is supported by a body of law for the economic arena in general, nor specific transactions, such as a contract.

Privatization requires legislative success in providing processes and procedures by which individuals and firms can exercise their economic rights. Such a success will require considerable diligence

to write the enabling laws. These areas of legal reform are vital to privatization:

- Taxation
- Ownership
- Bankruptcy
- Contracts
- Transfer of title
- Succession of interest
- Expropriation
- Commercial code
- Incorporation, registration, corporate liability
- Shareholder rights and obligations
- Clarification of "Spontaneous Privatization"
- Securities law, including law for joint stock companies
- Ownership implications of leases by joint stock companies
- Intellectual property law
- Labor laws
- Antitrust
- Freedom of international trade

Legal reform as applied to privatization appears to follow three basic steps: first, establishing clear ownership rights; second, setting clear rules for transforming enterprises into joint stock or other form-of-ownership entities; third, establishing clear and transparent procedures for privatization. The on-going debate in Estonia about all three of the above steps is lively and vigorous; significant progress has been made in many areas. Further progress is essential.

A further comment about antitrust is appropriate here. Many of the enterprises in electronics and in other industries have a monopoly position; indeed the whole economy of Estonia is rife with monopoly; there is little competition in anything. The best anti-monopoly strategy is a simple open borders policy for international trade. Build no walls at the border to protect industries, for behind every wall there will be a monopoly.

Appendix: Individual enterprises visited

A. Tallinna Tootmiskoondis Toostusaparaat

200107 Tallinn Lastekodu 48
Mr. Anatoli I. Makarov
General Director

Ms. Elena Jermakova
Deputy Economic Director

Mr. Nitikin
Chief of Planning Department

1,200 employees
Annual Revenues: 1991: 100 million RBLS.
Electromagnetic consumption meters, heat counters, transducers, switches, transformers, sensory devices for aviation

B. Tallinna Elektrotehnika Instituut

200103 Tallinn Pirita tee 20

Mr. Gunnar Toomsoo
General Director

Mr. Valentin Timofejev
Assistant General Director
400 employees
Annual Revenues: 1990: 10 million RBLS.
Semiconductors, test equipment for semiconductors, control systems for indsutry, transformers, data processing systems

C. Ettovote Shtamp

200103 Tallinn Pirita tee 20

Mr. Adolf Taikop
General Director

200 Employees
Tool and Die Shop

D. Teadus-Tootmiskoondis Elektrotehnika (ESTEL)

200100 Tallinn Telliskivi 60

Mr. Vladimir Mirosnitsenko
General Director

Power semiconductor devices (thyristors, diodes), transformers, power supplies for electric railway substations, electric drives of pumps, compressors

E. Tallinna Muundurseadmete Tehas
20014 Tallinn Betooni 6

Mr. Mikolai Adamov
Director

3,500 Employees
Annual Revenues: 1991: 170 million RBLS.
Power semiconductor devices (thyristors, diodes), transformers, power supplies for electric railway substations, electric drives of pumps, compressors

F. Tehas Volta
200110 Tallinn Toostuse 47

Mr. Boris Churikov
General Director

Mr. Jouri Khatchaturian
Sales Manager

3,500 Employees
Annual Revenues: 1991: 120 million RBLS.
Electric Motors

G. Poegelmann Electrotechnical Works
142 Parnu Street
200107 Tallinn

Mr. Juhan Jalakas
General Director

Mr. Abru Uno
Chief Technical Officer

2,500 Employees
Annual Revenues: 1991: 85 million RBLS.
Semiconductor devices, Linear integrated circuits, hearing aids

H. Tootmiskoondis Orbita Service
200006 Tallinn Liimi 1

Mr. Vello Rink
General Manager

800 Employees
Annual Revenues: 1991: 36 million RBLS.
Cable Television Installations, Television Repair Service, Individual and Communal Antennae

I. Tallinna Raadioelektronika Tootmiskoondis (RET)
200102 Tallinn Narva Mnt. 11

Mr. Aleksander Plustsajev
General Director

Mr. Tonu Aas
Chief Technical Officer

Both sites visited

J. Tallinna Raadioelektroonika Konstrueerimisburoo
Estonia Avenue 3/5
200090 Tallinn

Mr. Rostislav Lukin
Chief Engineer

Annual Revenues: 1991: 70 million RBLS.
Electronic digital voltmeters and calibrators, consumer electronics (radio receivers, turn-tables, audio amplifiers)

K. Estonian Academy of Sciences
Institute of Cybernetics
Akadeemia tee 21/1

Mr. Hari Tani
Deputy Director, Computer research and development division

Mr. Ants Work
Assistant Director

L. Tehas Eesti Kaabel
200106 Tallinn Kingissepa 64

Mr. Valeri Malosko
General Director

Mr. Vladimir Markov
Commercial Director,
EKSI Ltd. (Joint Stock Company)

500 Employees
Annual Revenues: 1989: 22 million RBLS.
Cables and Wires

M. Eesti Teadiste Akadeemia Konstrueerimisburoo
20018 Tallinn
Akadeemia tee 19

Mr. Karl Saar
Director

Mr. Heino Lind
Chief Engineer
270 Employees
Annual Revenues: 1991: 4 million RBLS.

N. Kamitra, Ltd.
Akadeemia Tee 21/1
20018 Tallinn

Mr. Heino Lind
Chairman

20 Employees
Chromotographic Instruments

O. Tartu Apparaadiehitus Tehas
Tartu
Flight data recorders, angular movement sensors, consumer electronics

P. Tartu Kontrollaparatuuri Tehas
Tartu

Engine control relay devices, industrial electronic pressure transmittors, pressure controls for refrigeration

In Association with:
Development Alternatives, Inc.

Electronics Industry Investor Guide

Submitted to:

Department of Foreign Economic Relations
and
The Ministry of Industry

Republic of Estonia

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Introduction

This document is an index of electronics enterprises in Estonia, providing general information on enterprises, their products, capacity and size. We have placed each company into one of three categories; large integrated enterprise, small entrepreneurial venture or retail and service enterprise. This guide is intended to serve as an introduction to Estonian electronics enterprises for foreign investors and other interested parties. Additional information is available directly from the listed companies.

It should be noted that the information contained herein has been supplied by the electronics companies and has not been independently verified. Because of the hyperinflation of the rouble in the last year, as well as the peculiarities of the accounting system used in the former Soviet Union, rouble figures given for annual revenues are mere indicators, rather than an accurate reflection, of an enterprise's financial position.

Technical applications, specifications and tolerances for products described in the guide have not been examined. We do not express opinions about the value of these products or their potential marketability in or outside of the former Soviet Union.

This information is current as of April, 1992.

Tallinna Tootmiskoondis Toostusparaat (Prompribor)
200107 Tallinn Lastekodu 48

Tel. 424955
Fax 426570
Telex Istok

Factory Director
Mr. Anatoli I. Markarov, General Director

Location
Tallinn

Year Founded
1978

Type of facility
Production, large integrated enterprise

Products or Services
Electromagnetic Flow Meters which measure the flow of liquids
Heat Meters which measure heat production and consumption for dwellings and industrial uses
Position Transducers
Switches, Transformers
Sensory Devices for Aviation
The flow and heat meters are used in industry for thermal and energy monitoring and in exploration equipment.

Product development time is estimated to be 24 months or less.

Markets and Customers
The former Soviet Union, Bulgaria, Mongolia, Finland, India, Cuba

Within Estonia, Proimbor has supplied a large number of heat meters for individual dwellings, industrial locations, and multipurpose buildings.

Annual Revenue
1991 – 100 million roubles

Number of Employees

1200, of which 30% are professional staff (technicians, engineers, administrators)

Physical Plant and Equipment

The plant is located on 44,000 square meters in a central industrial location in Tallinn, and there are two other sites outside of the city. Extensive testing facilities include test labs, research and development facilities, and quality control labs.

Ettovote Shtamp

200103 Tallinn Pirita tee 20

Tel. 0142-238-741
Fax 0142-238-877

Factory Director

Mr. Adolf Talkop, General Director

Location

Tallinn

Year Founded

1960

Type of facility

Production, small entrepreneurial venture

Products or Services

Tungsten Carbide and Other Hard Alloy Blanking Dies
Stator and Rotor Sheets, Diameter 20 to 400 mm
Wear resistance coatings

Shtamp produces single and multi-row dies for electrotechnical and oil industry plants. They design and produce cold forming dies for use with aluminum and copper alloys and low- carbon steel.

The company produces wear-resistant coatings mainly for cutting tools using a condensation with ion bombardment method.

Markets and Customers

Largely domestic and within the former Soviet Union. Major customers are in the oil and electrotechnical industries.

Number of Employees

200

Physical Plant and Equipment

The production facilities are located in historic buildings on the Tallinn waterfront. Manufacture and finishing of die parts are performed on high precision equipment purchased from Switzerland, Germany, Great Britain and Japan.

Teadus-Tootmiskoondis Elektrotehnika (ESTEL)

200100 Tallinn Telliskivi 60

Tel. 44 2451
Fax 49 5461

Factory Director

Mr. Vladimir Mirosnitsenko, General Director

Location

Main plant is adjacent to the central Old City in Tallinn. A second plant is located on 20 hectares in an industrial zone outside of Tallinn.

Year Founded

1870. Originally founded as a repair and maintenance center for railway cars. Since 1958 has been among the largest Estonian producers of power semiconductor devices and connectors.

Type of facility

Production association, large integrated enterprise

Products or Services

Power semiconductor devices
- Avalanched thyristors for voltage up to 1100v
- Rectifier diodes for voltage up to 1400v
- Inverter thyristors for voltage up to 1500v
- Power rectifier diodes for voltage up to 2400v
- Power thyristors for voltage up to 2400v

Transformers
Frequency Converters for railways and induction heating of metals
Ozonizers for drinking water purification
Rectifiers and inverters for DC substations in electric railways
Electric Drives for Pumps and Compressors
Microchips

Annual output is estimated at 1.1 million units.

Markets and Customers

Until recently, over 90% of sales were to the Soviet Ministry of Defense. In 1991, the Soviet Ministry of Electrical Engineering, Industry and Instrument Making turned the plant over to the Estonian Republic. Its market ties remain with the Republics of

the former Soviet Union.

Annual Revenue

1990 – 90 million roubles

1991 – 157.2 million roubles

Number of Employees

3500, of which 1200 are technicians and engineers.

Physical Plant and Equipment

The main plant consists largely of multi-story buildings. The industrial zone plant is a layout of one-story industrial buildings that are able to accommodate heavy machinery and equipment with significant warehousing, both indoors and out. The company has 14.4 hectares of land of which 45,000 square meters are considered usable.

Tehas Volta

200110 Tallinn Toostuse 47

Tel. 44-6002

Factory Director

Mr. Boris Churikov, General Director

Location

Tallinn

Year Founded

1899 as a private German-Estonian corporation.

Type of facility

Production, large integrated enterprise

Products or Services

Major producer of AC electrical motors and engines
Minor producer of consumer space heaters

Current production: 200,000 units per year
Maximum capacity: 250,000 - 300,000 units per year

Markets and Customers

Until recently, 90% of production was sent to the Republics of the former Soviet Union. A small amount of production has been exported to France, Turkey, Ireland, and Morocco.

Suppliers

Russian Republic

Annual Revenue

1991 – 120 million roubles

Number of Employees

3500, of which 30% are professional staff

Physical Plant and Equipment

Plant and machinery have not been significantly upgraded since the 1960's.

Poegelmann Electrotechnical Works

142 Parnu Street
200107 Tallinn

Tel. 441-005
Fax 557-494

Factory Director

Mr. Juhan Jalakas, General Director

Location

Tallinn, Estonia

Year founded and chronology

1958 Founded
1960 Began production of transistors.
1969 Began production of integrated circuits.
1979 Began production of hearing aids.

Type of facility

Production, large integrated enterprise

Products or Services

Poegelmann produces semiconductor devices, integrated circuits, and hearing aids built, for the most part, to customer specifications at the company's design and technology center.

Company literature lists the following products:

- Integrated circuits with operating voltages of up to 20v
- Planar thyristors with operating voltages up to 300 400v.
- Low noise amplifiers
- Programmable operational amplifiers
- Low voltage low noise amplifiers for hearing aids
- Low voltage integrated circuits for photographic equipment
- Radio and video integrated circuits
- Monolithic sample and hold amplifiers
- Linear semicustom integrated circuits
- High voltage triode thyristors
- Transistor arrays
- Hearing aids

4 models of behind-the-ear hearing aids with acoustical amplification from

40 to 65 decibels and maximum sound pressure level from 120 to 136 decibels.

Annual Production:	Integrated Circuits:	43,000,000 units
	Semiconductors:	2,000,000 units
	Hearing Aids:	280,000 units

Markets and Customers

90% of product goes to the former Soviet Union of which 1% is to the Baltics. The remainder is exported to India and China. The major customer was the Soviet Ministry of Health.

Suppliers

Russia: half-finished products for devices with p-n isolation, package materials
Ukraine: half-finished products for devices with dielectric isolation
Uzbekistan: packaging

Annual Revenue

1991 – 85 million roubles

Number of Employees

2,500, of which 18% are professional staff

Physical Plant and Equipment

Production process takes place in multi-story buildings. There are 26,000 square meters of production space. A design and technology support center designs the devices manufactured by the factory. The factory has its own supplies of gas and deionized water.

Tootmiskoondis Orbita Service

2000006, Tallinn Liimi 1

Tel. 52 4118
Fax 52 6411
Telex 173563 EKRAAN

Factory Director
Mr. Vello Rink, General Manger

Location
Tallinn

Type of facility
Retail and service enterprise

Products or Services
Orbita is the primary retailer of consumer electronic products, as well as the only full-scale service, installation and repair enterprise in Estonia. It also installs cable systems and group antennae. Its primary retail product is Soviet-made television sets. It also sells Phillips products and may soon sell Finnish cellular telephones.

Markets and Customers
Primarily, Estonian citizens. There are currently 1,000 cable subscribers in Tallinn, for which Orbita is the only installer and servicer.

Orbita is also the service representative for Phillips, Matsushita, and Samsung.

Suppliers
Television sets and other electronic products and components come from the former Soviet Union, for the most part Russia, where there are approximately 250 suppliers.

Annual Revenue
1991 – 36 million roubles, of which 6 million roubles are generated by the service portion of the company.

Number of Employees
800 employees, of which 15% are professional staff

Physical Plant and Equipment
The facilities are in modern buildings in Tallinn.

Tallinna Raadioelektronika Tootmiskoondis ("RET")

(Manufacturing Facility,
affiliated with Tallinn Raadioelektronika Konstrueersmisburoo)

200102 Tallinn Narva Mnt. 11

Tel. 42 3854
Telex 173270 MARS SU

Factory Director
Mr. Aleksander Plustsajev, General Director

Location
Tallinn

Type of facility
Production, large integrated enterprise

Products or Services
Please refer to Tallinn Raadioelektronika Konstrueersmisburoo for a listing of products and other information.

Tallinn Raadioelektronika Konstrueersmisburoo

(Research and Development Facility of RET)

Estonia Avenue 3/5
200090, Tallinn

Tel. 42 1888, 42 1205
Fax 21 0734
Telex 173108 SINUS

Factory Director
Mr. Rostislav Lukin, Chief Engineer

Location
Tallinn Radioelektronika Konstrueerismisburoo is located on the outskirts of the Tallinn industrial zone.

Year Founded
1935, as a manufacturer of radio receivers and related equipment

Type of facility

Research and development

Products or Services

Measuring and Calibration Instruments (32,000 pieces annually)

- Wideband true RMS AC voltmeters, AC and DC voltage measurement in frequency range 5Hz - 50MHz
- RF Voltmeters, frequencies up to 2 GHz
- Multimeters for DC, AC, and DC+AC signals
- Ohmeters for resistance measurements in the range 10^{-5} to 10^{16}Ohms
- AC and RF Calibrators
- Voltage converters for frequency ranges from 10Hz to 1MHz

Hi-Fi Equipment (110,000 pieces annually)

- AM-FM tuners and portable radios
- Audio amplifiers, preamplifiers and power amplifiers for output power up to 100W
- Turntables
- CD players
- Loud speakers
- Clock radios

Other

- Software, printed circuit boards
- Thin and thick film hybrid microcircuits
- Equipment testing and repair facilities

Markets and Customers

95% in the former Soviet Union, 5% abroad

Annual Revenue

1991 -- 70 million roubles

Number of Employees

3,000, of which 22% are professional staff

Physical Plant and Equipment

In the estimation of company management, 50% of current equipment will be usable for 10 more years; 50% will have to be replaced in the next 1-3 years. The research and development facility located outside of Tallinn is a modern, single level factory of Finnish construction. This plant is also used for assembly of consumer electronic equipment such as turntables, CD players, etc.

Tehas Eesti Kaabel

200106, Tallinn Kingissepa 64

Tel. 43 84 56
Fax 42 20 49

Factory Director

Mr. Valeri Malosko, General Director

Location

Tallinn

Year Nationalized

Year founded unknown, plant nationalized in 1951.

Type of facility

Production, large integrated enterprise

Products or Services

Cables and wires (in general, copper) for telephone and other communication devices.

1991 annual production was 450,000 kilometers of wire.

Markets and Customers

Markets are primarily in the former Soviet Union (94%)

Suppliers

Republics of the former Soviet Union supply copper and aluminum.

Annual Revenue

1989 -- 22 million roubles

Number of Employees

500 employees, of which 7% are professional staff

Kamitra Ltd.

(Production facility of the Estonian Academy of Sciences, affiliated with EKTA and EAK)

Akademia Tee 21/1
200018 Tallinn

Factory Director
Mr. Iteino Lind, Chairman

Type of facility
Production

Products or Services
Sophisticated chromatographic instruments used in a variety of scientific applications.

Markets and Customers
Mainly in the former Soviet Union.

Suppliers
Russia and other republics of the former Soviet Union.

Number of Employees
20

Physical Plant and Equipment
Relatively modern facilities provided by the Estonian Academy of Sciences.

Estonian Academy of Sciences (EKTA)
(Institute of Cybernetics)

Akadeemia tee 21
200108 Tallinn

Tel. 52 75 55

Factory Director
Mr. Hari Tani, Deputy Director

Location
Tallinn

Type of facility
Research & Development

Research and Development Activity
- Microprocessor-based control systems
- Systems and application software
- General purpose dedicated microcomputer systems
- Computer-aided test equipment
- Signal converters and computerized measurement systems
- Signal processing devices

Products
Microprocessor-based control systems
- Distributed control systems
- Laser control systems
- Computer control systems for chemical industry and agriculture
- Data logger and tester for power generators
- Pacemakers

System and application software
- Real-time operating systems
- System software for schools
- CAD software for control systems
- Application software for distributed control systems

General-purpose and dedicated computer systems
- Intelligent object-oriented workstation
- Computers for schools

- Local area network equipment

Automatic test equipment
- PCB tester
- PCB diagnostic system
- Field testers for control systems

Signal Converters and computerized measurement systems
- Various AC and DC converters
- Automated calibrator for digital voltmeters
- Noise meters and Instrumental amplifiers

Signal processing equipment
- Fast Fourier transformation coprocessor
- Pipelined preprocessor of radio signals

Other
- Power supplies for digital equipment
- Power supplies for signal converters and measurement equipment
- IC programmers

Markets and Customers
- Scientific and industrial research institutes
- Universities
- Industrial companies
- Agricultural enterprises
- Medical institutions

Eest Teadiste Akadeemika Konstrueerimisburoo (EAK)

(Design Office of the Estonian Academy of Sciences and Menteko Ltd.)

Akadeemia tee 19
200108 Tallinn

Factory Director
Mr. Karl Saar, Director

Location
Tallinn

Year Founded
1963

Type of facility
Research and Development.

Products or Services

-Excimer lasers and laser systems for scientific, medical and industrial applications
- Lidar systems for remote environmental monitoring
- Instrumentation for space shuttle experiments
- Preparative chromatographs for laboratory and pilot scale isolations
- Gas chromatographic (photoionization, electron capture, flame photometric, coulometric) detectors
- Surface area analyzers for research and quality control laboratories

Markets and Customers

- Former Soviet Union
- Central and Eastern Europe
- Scandinavia

In 1990, EAK supplied approximately 5% of total world production of excimer lasers.

Suppliers
Russia

Annual Revenue
1991 -- 4 million roubles

Number of Employees
270, including electronic and mechanical engineers, physicists, and chemists

Physical Plant and Equipment

Relatively modern facilities leased from the Estonian Academy of Sciences.

265

Tartu Apparaadiehitus Tehas (Tartu Instruments)
Kastani 42
Tartu 202400

Factory Director
Kaido Klaassen

Location
Tartu

Year Founded
1951

Type of facility
Production, large integrated enterprise

Products or Services
Tartu Instruments produces control instruments including:
- Electronic and mechanical relays for controlling diesel engines
- Electronic pressure transmitters for different industries
- Thermostatic expansion valves for different cooling agents
- Pressure controls for refrigeration and other equipment

Tartu Instruments also produces assorted consumer goods

Markets and Customers
Former Soviet Union

Annual Revenue
1991– 450 million roubles

Number of Employees
1300

Tartu Kontrollaparatuuri Tehas

Tartu, Estonia

Location

Tartu

Type of facility

Production, large integrated enterprise

Products or Services

Flight data recorders, angular movement sensors, consumer electronics

Markets and Services

Soviet military, Aeroflot, other entities in the former Soviet Union.

Annual Revenue

1991– 250 million Roubles

Number of Employees

2500

Baltijets Production Association
20200 Narva
Estonia

Tel. (01435) 31845, 24007
Fax (01435) 45997
Telex 308017, 308817 MAYAK

Factory Director
Valery I. Chetvergov, General Manager

Location
Narva, in North-east Estonia

Year Founded
1947, as a chemical manufacturing facility

Type of facility
Production, large integrated enterprise

Products or Services
Turbomolecular pumps and special pumps

Medical equipment
- Remote gamma ray apparatus
- Intercavitary gamma ray apparatus
- Blood pump
- Radioisotope chronoscope
- Gamma ray thyreoratiometer
- Medical radiometer
- Tourniquets
- Automated manipulators

Industrial applications of isotopes
- Radioisotope thermoelectric generator
- Gamma ray flaw detector

Electronic Equipment
- Personal computers
- Data entry and processing
- Software for determination of activity of radionuclides
- Multichannel pulse-height analyzer

- Radiometer-dosimeter
- Radioactive contamination detectors for personal use

Consumer Goods
- Plumbing fixtures
- Automobile parts
- Kitchen and cooking equipment

Markets and Customers

Former Soviet Union

Some foreign export market

Tallinna Elektroteknika Institut

Pirata tee 20
200103, Tallinn

Tel. 23 89 71
Fax 23 78 27

Factory Director
Mr. Gunnar Toomsoo, General Director

Location
Tallinn

Type of facility
Research & Development, Small entrepreneurial venture.

Products or Services
Semiconductors (diodes, thryistors, transistors) manufactured with silicon and gallium arsenide
Test equipment for semiconductor production
Control systems for industry
Transformers
Data processing systems
Infra-red technology for simultaneous translating devices

Computer hardware servicing
Diffusion welding for the tool and die and semiconductor industry

Markets and Customers
90% of product to the former Soviet Union
10% of product to the West

Annual Revenue
1991 – 10 million roubles

Number of Employees
400, of which the majority are professional staff

Sources

Institutions

Department of Foreign Economic Relations: Provided an industry overview.

Estonian Academy of Sciences: Provided information on new start-up enterprises.

Estonian Electronics Associations and Estonian Electronics Unions: Arranged site visits.

Each company supplied all brochures, annual revenue and employee figures.

Site visits

The project team visited all of the electronics companies included in this guide. The team met with management, toured facilities, and gathered information on products and financial condition.