

**FORUM
ON
“AFTER FIFTEEN YEARS OF MARKET REFORMS IN TRANSITION
ECONOMIES: NEW CHALLENGES AND PERSPECTIVES FOR THE
INDUSTRIAL SECTOR”**

Trade, Industry and Enterprise Development Week
UNECE
24-25 May

**MIRACLE OF ESTONIA:
ENTREPRENEURSHIP AND COMPETITIVENESS
POLICY IN ESTONIA**

by

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UNECE Palais des Nations, Geneva 2005

STARTING POSITION - WILLINGNESS FOR REFORMS BUT NO CONCRETE EXPERIENCES!

Over ten years Estonia has experienced great changes in its economy and society. As Estonia was part of the Soviet Union, the economic activity was dictated by the needs of centrally planned system and Estonia was almost cut off from the Western European countries. Regaining the independence put Estonia to completely different situation – metaphorically, Estonia had to start from zero.

Weak starting position:

- State owned companies
- Guaranteed product-markets
- Fixed prices
- Deficit in goods and services
- No open economy, no real value for money
- No real financial intermediation
- Guaranteed jobs, no motivation.

The overall goal of economic policy was exactly the same as in many other countries – to achieve sustainable, socially and regionally balanced economic growth. It has been characteristic of Estonian economic reform that no branch of economy has been preferred, practically the only determining factor in the restructuring has been the ability of an enterprise to adapt itself to economic conditions, especially its ability to orientate itself to the Western market. Estonia chose very liberal form of market economy and set up simple and clear rules for that. There exist two types of economist, where ones prefer quick reforms, who support shock therapy approach and the others step-by step approach.

Estonia used the first one starting with very quick reforms – there was freeing up prices, introduction of own currency, and tight fiscal policy, also starting with privatisation and liberalised FDI and trade quite quickly. To manage transition from centrally planned economy to market economy Estonia choose in one hand macroeconomic stabilisation with monetary policy, exchange rate policy and fiscal policy and in other hand structural reforms like price liberalisation, trade liberalisation, FDI liberalisation, banking sector reform, privatisation, enterprise reform and competition policy. In 1992, *Estonia introduced its currency* – kroon. Estonian kroon was fixed to the German mark. Under the currency board agreement the kroon was made fully convertible for current account transactions and no restrictions on capital account convertibility were imposed. At the introduction of kroon, the value of Estonian kroon was undervalued by purchasing power by 7-8 times, so it favoured the exports of goods and services but made imports more expensive.

Before re-independence the structure of industry and also the prices originated from centrally planned economy. Therefore the prices did not reflect the actual production costs. *Price liberalisation* in Estonia started already in 1989 and because the price structure in that time was very distorted, the price liberalisation brought along high inflation. In 1992, the consumer prices rose more than 10 times. Since then the inflation rate slowed down considerably.

The privatisation started in 1991. The main privatisation methods were tenders with preliminary negotiations, public auctions and public offering of shares. Applying of insider advantages was limited, therefore important role in privatisation played foreign capital, which had major effect on restructuring of the enterprises. By 1998 the privatisation was almost complete.

Important decision was also full liberalisation of trade. Estonia as a small country cannot rely only on its domestic market, foreign trade helps to compensate small size of the economy. Estonia abolished all import tariffs. Openness to foreign markets allowed to import all the needed investment goods and to reconstruct the industry, but it put also the local enterprises into situation of harsh competition. This again speeded up the restructuring process, which resulted in reorientation to Western markets and active search of new trade partners. The volumes of exports and imports have increased rapidly. Due to the lack of natural resources and high need for investment goods, the imports of goods has exceeded volume of exports and the surplus of trade of services has not compensated it.

In situation, where the need for restructuring was high and local enterprises had not enough resources, the general sources for financing were foreign investments. The macroeconomic framework was attractive to foreign investors and even there were no special incentives for foreign investors in place (the foreign investors are treated the same as Estonian ones), the FDI inflow was widespread and it played important role in restructuring process. At the first stage, FDI inflow was mainly related to privatisation but also after completion of privatisation the FDI inflow continued to increase. Foreign investments acted not only the role of capital. Foreign investments supported know-how transfer and inflow of new technologies and it was one reason behind fast restructuring of the economy.

Openness and liberal attitude made Estonian economy open to external influences which meant that in the case of totally distorted structure of economy (from the market economical point of view) there were necessary big structural changes for survival in international competition. As industrial and economic structure was not appropriate in these new conditions and the reorientation from Russian to Western markets was due to the mismatch of requirements not easy, Estonia experienced sharp decline in production in all branches of economy. In 1994 the level of GDP was more than a third below the level of 1990. But even the drop in production was sharp, it did not last long. After the recession, Estonia has experienced high economic growth. The structure of the economy transformed quickly and with ten years it was already similar to that in the Western countries.

Restructuring had major effects on labour market. The optimisation in enterprises involved reduction of work force, also the requirements for labour qualification and generally for work practices changed and it put great pressure on people. The result of restructuring was the rise of efficiency but that decreased the demand for labour and therefore unemployment increased rapidly until the year 2000. Especially in former agricultural and industrial regions, the shock was the deepest.

SUCCESS FACTORS INITIATING GROWTH

1. **Macroeconomic stability:** Estonia has balanced government budget, fixed exchange rate system and tight fiscal policy, currency board system, conservative foreign borrowing policy and successful structural reforms.

Estonian kroon is fixed to euro and we have no problems with public deficits or excess inflation. Estonian government is strongly committed to fulfill the criteria of the Stability and Growth Pact and to join the eurozone, perhaps as early as in 2006. This is expected to be a relatively painless procedure, as the exchange rate has remained fixed for more than ten years now, as Estonia has been using the Currency Board arrangement. Thus, replacing kroons with euros will be mostly cultural and sentimental problem, not economic issue.

2. *Simple and Transparent Tax System*

A special feature of Estonia's tax system is the fact that profit is not taxed until it is taken out of the company – so the re-invested earnings of enterprises are not taxed. The system is directed to taxing areas that need intervention instead of taxing entrepreneurial spirit.

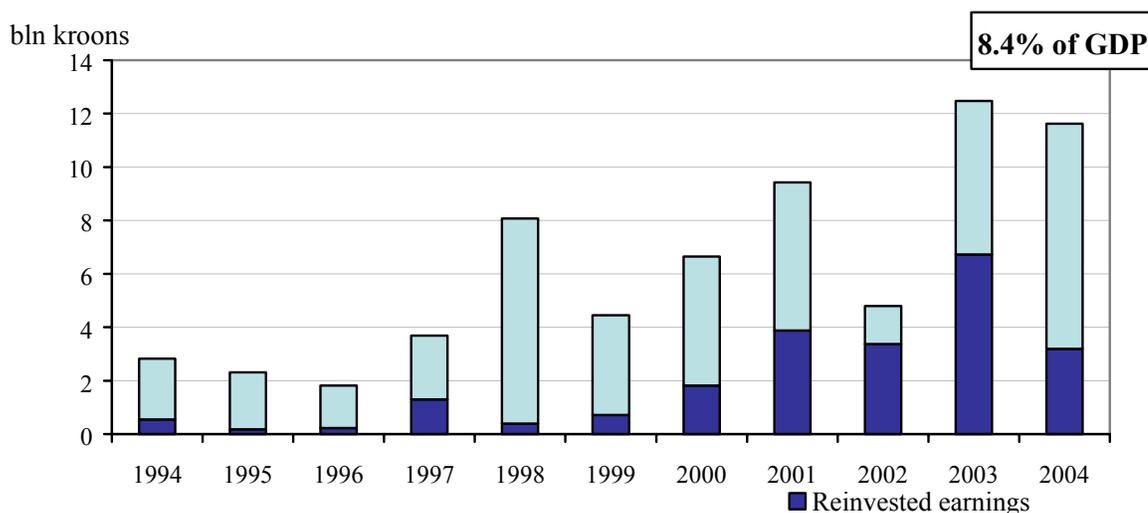
The decision not to tax the reinvested profit was made to initiate further foreign and local investments into Estonian economy, and that has been rather successful. Estonia is among the top recipients of foreign direct investments in the Eastern Europe on *per capita* basis. It is worth mentioning, that a large share of the investments are re-invested earnings – this shows the benefits of our tax system and proves that existing investors are satisfied with the conditions we have created. That kind of taxation policy also encourages the enterprises to invest more in new technology as well as in upgrading the skills of their workers. In fact due such taxation policy the reinvestments from undistributed profits have in recent 4 years increased almost 10 times and even, the revenues to state budget have increased that many now be used for those who need it.

Estonia introduced a rather revolutionary tax code that sets a common income tax to everyone, with a flat level untaxed income. That was rather unique in Europe, where countries feature very complex and highly progressive tax systems, setting back people's initiative to work and earn more. The individual income tax level is currently set to 24%, and government is taking steps to lower the tax burden for individuals and enterprises, while keeping the policy of firmly balanced budget. The income tax rate is set to lower to 23% by year 2006.

In 2004, FDI inflow amounted 8,4% of GDP. Since the year 2000, when reinvested earnings were exempted from income tax, the share of reinvested earnings in FDI has grown substantially (3/4 in 2004). Largest investors are from Sweden and Finland. Most attractive sector to foreign investors has been financial sector. Large investments have made Estonian banking sector to well functioning and highly developed sector. Over 90% of the banking sector belongs totally to foreign owners or strategic investors. Generally, investments have spread to all economic sectors but like in other spheres of economy they are concentrated around capital city.

Also Estonian market is small the situation has changed after Estonia joined the EU. Investors will gain access to the EU market with relatively low resource cost base provided by Estonian economy. The EU membership offers us an opportunity to further enhance our infrastructure and to increase the investment into training and education of our people. This should be a good incentive for companies willing to invest to Estonia – their investment will grow together with Estonian economy.

Graph 1. FDI into Estonia (billions kroons).



3. Liberal Trade Regimes

By 1992, Estonia had abolished all tariffs, subsidies and other trade distortive measures on both industrial and agricultural products, after 1 May 2004, Estonia implements the Common Trade Policy of the EU.

The integration to the world economy can be most clearly seen in foreign trade. The volume of export of goods and services constitutes over 80% of GDP, the import figures are even larger. This is the result of very liberal trade policy. Estonia was couple years ago essentially a duty-free country concerning import tariffs, but the EU-accession means that Estonia must use the same restrictions to the third countries, as does the EU because of the common foreign trade policy. Due to the fact that almost 80% of Estonian trade is carried through with EU partners, these trade restrictions in general have marginal effect.

Sometimes observers have expressed concern, that Estonia could lose some of its economic freedom after joining the EU. As shows the survey conducted by Wall Street Journal and the Heritage Foundation, Estonia has 4th place in the Index of Economic Freedom 2005 and has even improved its position compared to year 2004 when Estonia were on 6-7th place.

Estonian economy is very free and liberal but at the same time following all European standards and laws on property rights a fact established by numerous surveys an international comparisons. By World Economic Forum Estonia is ranked among the top 20 for the competitiveness of economy in 2004 (Estonia held 22nd place in 2003). In 2004 World Economic Forum published also a survey called “The Lisbon review” to assess the policies and reforms in Europe in light of the Lisbon process. In this survey Estonia ranked as the most competitive new member state, earning high scores in categories of Financial Services, Enterprise development, International networks, Liberalization and Information Society development.

4. Well-focused Enterprise Support System

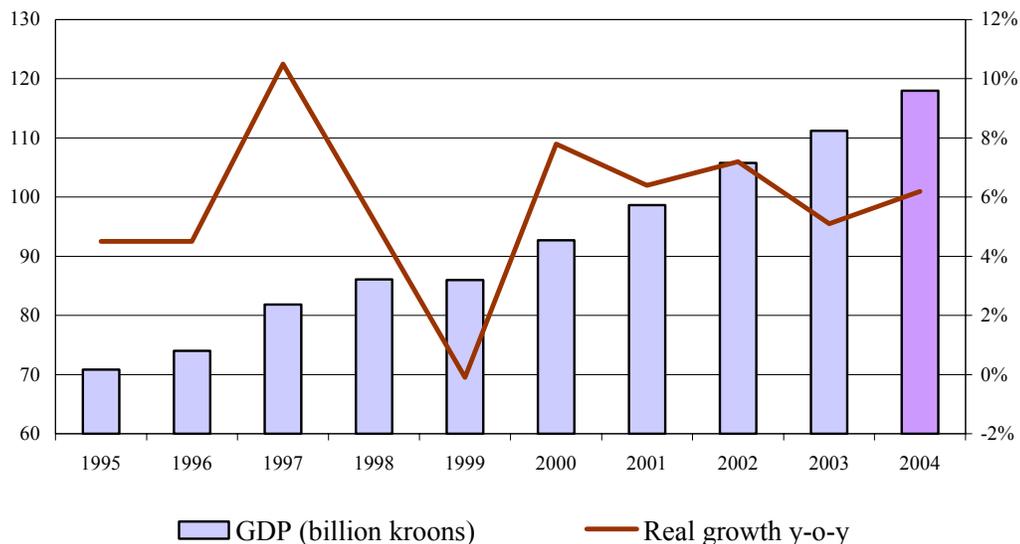
Estonia has developed good SME support system with well-focused SME support measures. Estonia has tried to make a difference without creating a distortion – the support measures are oriented directly to the market failures. The specification of the support services originate from the needs of firms changing over time. This will alter the types of intervention, as that will be needed to shift company behaviour as it develops. Estonia has range of support services, some of which are oriented to all businesses – awareness raising, interactive information G2B gateway www.activa.ee etc and some of which are limited to a only very few businesses for example R&D development programmes and promotion of quality management.

Economic development in last ten years has been remarkable but there is sill big gap with developed countries.

CURRENT ECONOMIC SITUATION AND ECONOMIC PROBLEMS

The cornerstones of Estonian economy today are the same as laid down at the beginning of transition process. Estonia is using liberal price, wage, trade and investment policies. The exchange rate has been stable. Estonian government is using tight fiscal policy and the tax system has been kept simple.

Graph 2. Real growth of GDP in Estonia (1995-2004).

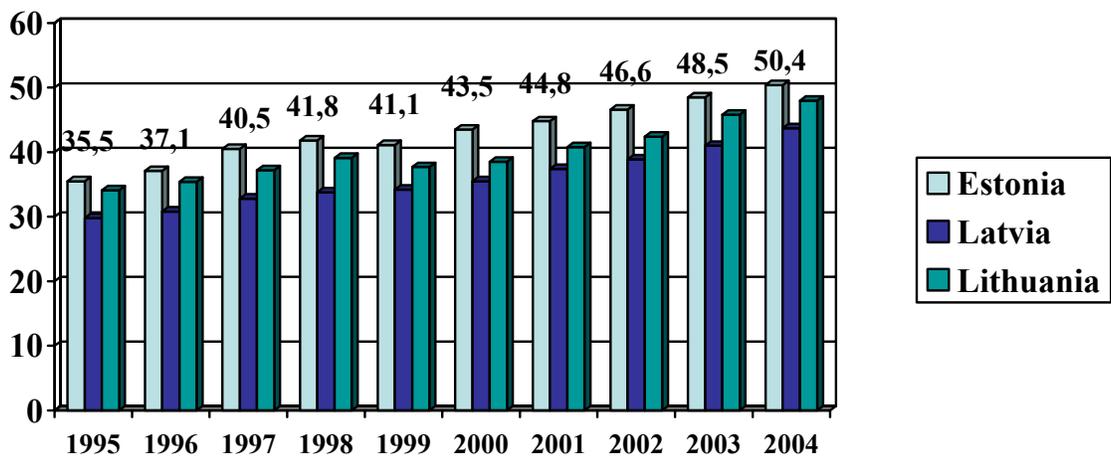


Solid macroeconomic framework and due to the rapid reorientation, Estonia has experienced fast economic progress. Annual economic growth has been in last years approximately 6% on average, which is clearly faster than in the EU. The growth has been driven mainly by investments. High growth rates can be partly explained by the low basis of economic development – GDP per capita in purchasing power standards is only a half of the EU's level. Even with such high growth rates as Estonia has experienced it takes many decades before Estonia can reach the level of developed countries.

Today we can see that the economic growth has been evident since 1995. The GDP increased in 1995 4.3% and in 1996 3.9%. During 1997 the growth speeded up. In 1997, the GDP increased 10.6% and in 1998 4.0%. Feedback came in 1999 when GDP declined by 1.1% because of negative influence of Russian and Asia. The Russian financial crises had strong effect on Estonian industries whose main export target was Russia (specially food industry). Due to significant changes in foreign trade and economic relationship from east to west during the 1990s, the effect of the financial crises in Russia had a relatively moderate influence on Estonian economy. The healthy growth rate in 2001 and 2002 in the conditions of global slowdown is strong evidence of the flexibility of Estonian economy. For couple years there has been slowdown in the world economy but Estonia has been able to manage relatively well in this conditions. This is the result of successful reforms and also smallness and flexibility of the country has been advantageous.

Also the Estonian GDP per capita is currently about 50% of average EU level, the growth of GDP, however, has doubled that of the EU and reached more than 5% on average in the last 8 years. In 2004 the growth of GDP was 6,2%.

Graph 3. GDP pre capita in PPS (EU 25=100) [%]



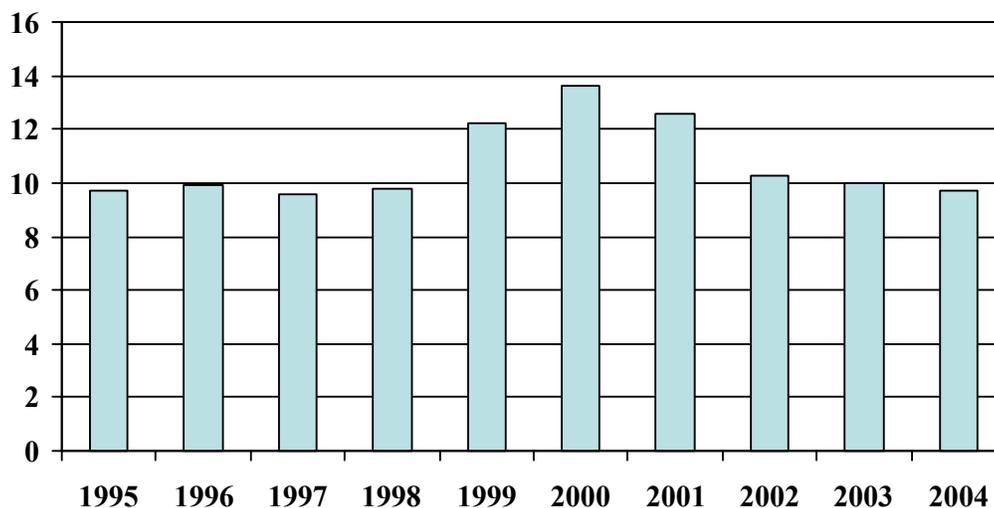
Already for some years the *inflation rate* is comparable with price movements in Europe. In 2003, Estonia recorded all-time low growth-rate in consumer prices - 1.3%. Considering the fact that the price level in Estonia is still approximately two times lower than in the EU and there are no essential restrictions for price convergence, the inflation rate in Estonia will be higher than in developed countries for some time. It will affect mainly the prices of internationally non-tradable goods and services. The main reason behind lower price level is the low level of incomes.

During the last years, *wages* have grown more than prices (over 10% in a year), so the standard of living has increased. Despite high wage growth, the wages in Estonia are still much lower than in Western European countries. Average gross wage in Estonia was last year 460 euros in a month, the labour costs in Estonia is almost five times lower than in the EU. Keeping in mind the lower price level, the difference between Estonian and developed countries' purchasing power of wages is not so

enormous. Low wages and salaries are determined by the level of productivity. The reasons of low level of productivity are big share of low value added industries, big share of subcontracting and modest R&D and innovation activity. Low labour cost has been a our short run competitive advantage.

Unemployment that resulted from structural changes has decreased since the year 2000, but still one tenth of labour force is not employed. Unemployment is highly correlated with regional problems and also the poverty is related to this issue. The roots of the problem are most certainly structural – since 1990 nearly 100 thousand people have flown out of the employment and the main reasons were: making the economic process more efficient - i.e. transforming the “hidden unemployment” into the not hidden one. There is mismatch in the labour market at the level of occupations and qualification, as well as regionally. Due to the inadequate and out-of-date vocational education, the unemployment rate is high among the youth. In situation of high unemployment, there are also problems finding qualified labour.

Graph 4. Unemployment rate in Estonia (in 1995-2004) [%]



However there has been structural break in Estonian labour market in the middle of 2000. Since then the unemployment has constantly decreased and in average 1,5 % in a year. To increase employment, the government has undertaken to increase the share of active measures in labour policy. It consists for example implementing efficient tax exemption and training systems, creating legal framework for supporting active ageing, forming a system providing opportunities of life-long training for everybody.

TODAY...

Estonia is faced with the same challenge as the rest of Europe: to become a competitive and dynamic knowledge-based economy capable of sustainable economic growth with more and better jobs and greater social cohesion. Development towards the knowledge-based economy is supported by the innovative, open-minded attitude of society. Significant progress has been made in moving towards information

society, that would be best characterised by profound prevalence of information and communication technology. But harder part is yet ahead.

Stable macroeconomic environment and cheap manufacturing resources have attracted foreign direct investments, but to have large investment inflow in the future, more active marketing is needed. Therefore promotion of the economy is continuing through image creation and direct marketing, there are offered investor services and post-investment services. Preferred are technology- and capital-intensive investment projects, which are focused on export and creating modern jobs.

NATIONAL POLICIES FOR SUPPORTING ENTERPRISES DEVELOPMENT

1. Enterprising Estonia

The cornerstone for enterprise policy in Estonia has been Estonia's enterprising policy "**Enterprising Estonia. National Policy for the Development of Small and Medium-sized Enterprises in Estonia in 2001-2006**" aims at creation of new jobs and improving the competitiveness of Estonian businesses. According to the "Enterprising Estonia" the major problems of Estonia's SMEs are limited financing opportunities, shortage of qualified labour and administrative obligations. In addition to earlier mentioned problems, starting enterprises often lack sufficient information about the regulative and administrative business environment and the public support measures.

2. Knowledge-Based Estonia

With Estonia's small size and limited resources, Estonia cannot achieve success in every economic field. Thus taking into consideration our competitive advantage, Estonia builds her future success on developments in the areas of R&D and ICT. Our R&D developing strategy is **Knowledge-based Estonia** – Research and Development Strategy for years 2001-2006.

The policy document establishes the framework and the scope of public sector support measures for R&D activities for 5 years and addresses to renewal of the knowledge base and increasing the competitiveness of Estonian businesses. Targets of the policy are as follows:

- Competitiveness and value added of traditional industries
- Creation and growth of new technology based companies
- Modernisation of public sector services

Estonia acknowledges fully, that we must quickly make a shift from cost-based competitiveness towards knowledge-based society. Our long-term economic development is orientated towards increasing the role on knowledge-based economy by stimulating private investments into research and development. The fact that EU market will become the home market for local enterprises and both enterprises and research institutions are able to participate in European cooperation networks, for instance through the EU framework programs, will be a great help in achieving this goal.

Estonia has set the goal to increase the expenditures on R&D up to 1.5% of GDP until 2006 and up to 3% until 2014. A small country cannot manage to be successful in all areas of R&D. Our key areas are: ICT, biotechnology, technology of materials. Estonia has launched several programmes to raise innovation awareness in the society and increase the cooperation between research institutions and enterprises.

The launch of the SPINNO program has stimulated the activities aimed at fostering the entrepreneurial role of universities and public research centres, especially in the field of high tech venturing.

Development of knowledge-based society is closely attached to the **development of ICT infrastructure**. Estonia has set goals to increase Internet penetration by lowering connection prices and promoting competition between operators, to increase digital literacy and broaden IT training, to take advantage of innovative IT services like online health services, online study and e-Government. The penetration of internet and mobile devices is high, meaning a large number of users and customers for IT services. More than 50% of Estonians are now daily users of computers and internet – meaning people who use internet at least one a week. 90% of banking transactions are made using electronic channels. Interesting and useful services that are already used by considerable number of people are provided by both public and private sector. As an example, in 2004 78% of taxpayers sent their income tax returns electronically to Estonian Tax Board. Estonia has developed a tool for electronic identification of citizens over internet – an electronic ID card, that is compulsory for everyone and allows for the development of endless range of e-services that require secure authorization. Parking tickets are sold over SMS services, mobile phones are used to pay for goods and to borrow money to or from a friend.

3. *“Success Estonia 2014”*.

In order to stimulate competitiveness, several areas need to be focused simultaneously. Competitiveness is at first associated with economic growth and success of local enterprises. This expands to the capital- and labour market, financial market and education system. The cohesion of different policies is well brought out in **“Success Estonia 2014”**. While the main goal is to double Estonia’s living standards by 2014, it brings together many national and international strategies. Estonia’s competitiveness strategy “Success Estonia 2014” covers different spheres of life (environment, health, education, R&D, labour market, SME’s) and aims at raising considerably Estonia’s living standards. “Success Estonia 2014” largely proceeds from the principles and components of the European Union Lisbon strategy, to be implemented with a view to Estonia’s circumstances and peculiarities. It sets out the principles and goals for promoting Estonia’s competitiveness and socio-economic development, as well as priorities in the form of success factors. The main goal of “Success Estonia 2014” is to double the living standards of Estonia’s population by 2014. This can only be achieved by meeting the targets set in several sub-goals: labour productivity growth, increased employment, birth rate increase, reduced inequalities in society, reduced pollution load.

The future success and competitiveness of Estonia relies on key areas or success factors like highly qualified and mobile workers, enterprise-friendly economic environment, research, technology and innovation, large-scale adoption of information technology and healthy environment. Policy-mix in Estonia is definitely pro-growth and pro-competitiveness, but at the same time it is focused on long-term sustainable development rather than fast economic take-off that might harm the environment.

The process “Success Estonia 2014” simplifies the processes of managing the public sector and at the same time brings it closer to the society and this is something all governments should aim at.

Business Support Structure

The business support structure consists of two large foundations – **Enterprise Estonia (EE)** and **Credit and Export Guarantee Fund (KredEx)**.

Enterprise Estonia was founded in 2000 by the Ministry of Economic Affairs with the aim of promoting the competitiveness of the Estonian entrepreneurial environment and Estonian businesses. Enterprise Estonia is one of the largest institutions within the national support system for entrepreneurship in Estonia, providing financing products, advice, partnership opportunities and training for entrepreneurs, research and development institutions and the public and third sectors.

Enterprise Estonia actively operates in the following areas: the enhancement of the competitiveness of Estonian enterprises in foreign markets, the inclusion of foreign direct investments, the development of tourism exports and indigenous tourism, the elaboration of technological and innovative products and services, the development of Estonian enterprises and the entrepreneurial environment and the enhancement of general entrepreneurial awareness. Enterprise Estonia is one of the institutions responsible for the implementation of EU structural funds in Estonia, as well as being the primary provider of support and development programmes targeted towards entrepreneurs.

In October 1, 2003 a new structure of Enterprise Estonia was enforced. It is based on the strategy of Enterprise Estonia, which stipulates that the priority activities are the support of newly-established enterprises, the enhancement and development of enterprises already in business and developing entrepreneurship and living environments on a regional level. The new structure has been designed in accordance with the clients' needs and complies with the requirements set out by the implementation unit of EU Structural Funds and enables Enterprise Estonia to administer large-scale activities aimed at entrepreneurship, regional development and tourism. The previous agencies of Enterprise Estonia have been re-organised into three divisions: the Business Start-Up Division, the Business Development Division and the Business and Living Environment Division.

In January 2003 Enterprise Estonia adopted **Strategy of the Network of Business Advisory Centre**. BACs act as the primary gateway to information, advice, training and access to grant support for SMEs and all people in the local area thinking of starting a business.

Since its foundation in 2000, **Credit and Export Guarantee Fund - KredEx's** objective has been to improve the financing possibilities of the Estonian SMEs, reduce their credit risks in exporting and to enable people buy or renovate their homes. KredEx is a self-sustaining fund in the jurisdiction of the Ministry of Economic Affairs and Communications.

In the area of business loan guarantees, KredEx operates in compliance with international practices and the Estonian Competition Act. On the basis of the directive issued in 2001 by the Estonian Ministry of Finance, KredEx was given a permit to grant state aid. According to the new law of Enterprise Support and State Guarantees for Loans Act, which became valid from May 2003, KredEx's business and housing loan guarantees will be counter-guaranteed by the state. The state will cover the business loan guarantee portfolio up to 32 MEUR and the housing loan guarantee portfolio up to 45 MEUR. Before that the banks and leasing companies had no guarantee against the bankruptcy of KredEx. Thus, with the new law KredEx's loan

guarantees became even more trustworthy for the financial institutions issuing loans to SMEs and the private sector.

In May 2004, KredEx signed a co-operation agreement with the European Investment Fund for counter-guarantee 50% of the risks taken by Kredex while guaranteeing investment loans issued by Estonian banks. The co-operation of KredEx and European Investment Fund is organised under the SME support programme Multi-annual Programme for Enterprise enables to support different entrepreneurship programmes all over Europe, including loan guarantees. KredEx is the only organisation in Estonia to have received the loan guarantee support within the framework of the MAP programme with no extra cost to the state budget. Reducing KredEx's risks by 50%, EIF enables KredEx to offer their service to the Estonian entrepreneurs at more favourable rates, as well as to increase its portfolio.

KredEx guarantees up to 75% of the working capital and investment loans; the leasing guarantee covers up to 40% of the principal amount outstanding. The guarantee fee is paid by the borrower and reflects the credit risk of the project. In addition to that, KredEx will start securing bank guarantees. The target group for this product is entrepreneurs, whose economic activities need bank guarantees to their products or services. KredEx's guarantees can be adapted to most of the guarantees issued by the Estonian banks, the most common of which include payment guarantee, tender guarantee, advance-payment guarantee, implementation guarantee and deadline guarantee.

*In addition, Estonia has several information portals for entrepreneurs. The national portal for entrepreneurs Activa (www.aktiva.ee) is a G2B gateway to information and services for small and medium-sized businesses. Its main function is to supply entrepreneurs with the information and services necessary for business activities and development. Aktiva.ee facilitates the access of free systematic, thorough and regularly updated information provided to entrepreneurs by the public and non-profit sectors as well as business and economic news and an overview of internet resources available. Aktiva.ee is available in Estonian and Russian. The portal focused on managing the SMEs is **Estonian Management Quality Centre** (www.ejk.info). Like the name says, this portal is created to improve the quality of enterprise management through promoting managerial information, best practices, research -, training - and consultation services. The partners of Management Quality Centre include private – and public sector organisations (Ministry of Economic Affairs and Communications, Ministry of Finance, magazine “Director”, Estonian Quality Union, Business Grain OÜ, Technical University of Tallinn and Estonian Chamber of Commerce and Industry). Portals promoting entrepreneurship are fine examples how public-, private- and third sector work together for a common goal.*

Business support services

Basic-Services – All SMEs

- G2B information gateway
www.aktiva.ee
- Information services
- Awareness rising
- Entrepreneurship promotion

Diagnostic Services – Few SMEs

- Start-up aid
- Mentoring Programme
- Support for training and advisory services
- Support for development of business infrastructure
- Export planning programme

- Participation in trade fairs
 - Feasibility study and product development grants
 - Development and marketing of tourism products
 - Training grants
 - Consultancy grants
 - Promotion of Quality Management
 - FDI promotion
 - Infrastructure Development Grant
 - Export and Business Guarantees
 - Export Plan Preparation Grants
 - Export Markets Information
 - Innovation awareness, awards, training etc.
 - Innovation audit
 - Loan, leasing and export guarantees (KredEx)
- R&D Project Support – Selected Partners**
- SPINNO Program
 - R&D Feasibility Grants
 - R&D Infrastructure Grants
 - Technology Parks and Incubators
 - Competence Centre Program

Current situation – Statistics of Estonian Enterprises

According to the statistics of Estonian Custom and Tax Board by the end of 2003 there were 37 454 active enterprises in Estonia (sole proprietors – 35 387 – are not included). That makes 28 enterprises per 1000 inhabitants which is relatively less than in well developed EU countries and shows off the low entrepreneurial activity in Estonia. Practically all Estonian enterprises are small and medium-sized while only 0,41 percent of all the enterprises can be classified as large. The survival rate of Estonian new enterprises is quite low and only a little more than half of Estonian companies survive during three years of action.

Since SMEs contribute highly to Estonian GDP it is crucial to support the growth of enterprises and the value added in them in order to achieve fast sustainable economic growth. For Estonian market is very small every form of internationalisation should be supported. At the moment 15% of Estonian firms export their goods or services. R&D activities and expenditure are also low and that keeps the value added in the companies down. Productivity and product quality growth could lead the international competitiveness of Estonian companies to a new – higher level. The number of active enterprises has been growing slowly but steadily about 6% per year (the same number of growth was in 2002), mainly because of the increase of the number of micro enterprises growth 45%. **If we could develop the rate of companies to survive during three years of action and develop their sustainability the number of active enterprises would rise dramatically.** It refers to the continuing restructuring process of Estonian economy. **STILL AHEAD –...**

At the moment a draft SME policy document for years 2007-2013 has been composed with the aim to improve the international competitiveness of Estonian enterprises. The goals of the policy are as follows:

- **to build strong enterprise culture – new goal in SME policy**
- to build the capability for small business growth and internationalisation
- to improve access to finance for small businesses
- to improve small businesses' experience of government services
- to develop better regulation and policy

...THE FUTURE CHALLENGES...

There is a saying “if there’s a will there’s a way”.

During the recent years Estonia has made many efforts and put in place the growth- and stability oriented macroeconomic environment, which is prerequisite for creating a climate conducive to entrepreneurial initiative. So today we can say that there certainly is a “way” and the “way” is smooth as possible.

On the other hand it seems at this point that the greatest problem with our enterprises is **the lack of willingness to start and grow a business**. Government can make efforts to make business environment of a country the best in the world by encouraging dynamic start-up markets and improving access to finance for small business or develop better regulations and policy *etc* but if there are not enough individuals with entrepreneurial set of mind all those efforts does not lead to the success.

The evidence of the lack of entrepreneurial spirit comes from the Estonian survey on entrepreneurship when a total of 1000 working age people were interviewed by telephone, at the end of year 2004. According to the results only 9% of Estonian working age population has thought about starting their own businesses. These 9% are respondents who actually are attempting to start their own business. But more than half of the working age people (61%) have never thought about establishing their own business. In addition 11% of population was starting or running a business, 16% of population had in the past thought about starting a business but they had already given up the idea and 3% did not have clear opinion

The main reasons given by Estonian respondents to explain not starting a business are perceived to be the lack of funding (71%), the fear of debt (61%), the fear of loosing security (59%) and failing (53%) and the last but not least is the low consciousness and knowledge (49%). All mentioned reasons given for not to starting a business refer to the fear of doing business once again which refers to the to lack of knowledge about what it means to be an entrepreneur and what it takes to have one’s own company.

Today it is crucial to make an extra effort to change attitudes of wider publicity as Estonia and most likely also the other new member states suffer from low awareness on entrepreneurship as well as unfavourable attitudes. A comprehensive approach to promoting strong entrepreneurial culture must effect on every level and in every moment of the businesses lifecycle. For the sake of new enterprises and enhanced growth we need to boost up our entrepreneurial culture so that people would:

- 1. want to be an entrepreneur...(positive attitudes in whole society)**
- 2. know how to be an entrepreneur...(competence, knowledge, skills)**
- 3. have enhancing environment that enables to everyone to act as an entrepreneur...+ co-operation at all levels.**

To motivate individuals to decide for entrepreneurship the first thing that should be done would be rising the awareness of what it means to be an entrepreneur and what is the overall conception of entrepreneurship. The opportunity of running a business should be made a sufficiently attractive and people should be equipped with the right skills to turn ambitions into successful ventures.

As entrepreneurial activity is closely related to the right appreciation of entrepreneurs in society the role models of entrepreneurs and the entrepreneurial success should be valued and the stigma of failure reduced. Success stories to showcase entrepreneurs and highlight the benefits that the entrepreneurs bring to society should be valued.

In addition there has to be guarantee that entrepreneurship is accessible to every member of the society. It is one of our greatest challenges to raise the consciousness, knowledge and skills of doing business and make efforts to build strong enterprise culture in all of its possible aspects.

As mentioned before not only arise in entrepreneurship results from higher knowledge and more favourable attitudes ensure the economic growth. Also the sustainability and growth of existing companies is essential. According to the statistics of Estonian enterprises one of the main problems is still the low rate of survival which occurs to the low knowledge about running a business.

In addition, as Estonia is a small country and it is natural for us to be small we also need to emphasize the benefits of co-operation. Co-operation between companies at different levels, co-operation between the public authorities and the companies, the companies and educational institutions, international cooperation at all levels etc. It is one of the strongest cornerstones of enterprise culture to have different institutions – formal and informal – to support each other. Thus we need to develop the ability of different institutions to co-operate and seek for the synergies resulting from mutually successful co-operation.

The problems are interconnected with each other and therefore there is no easy solution. As years ago we don't have a package of "must do's" and "ready to implement" instruments so once again we have to take risk of experimenting. The implementation of the measures is also hindered by the complexity of problems and therefore the choice of the optimal set for solving the problems is not easy. But as there has been fast development going on in the economy, so is the public sector in Estonia learning and becoming more aware of consequences of its decisions and the targeting of policy will be more precise. We have to remind that economic policy measures are not targets of our activities but the economic growth comes from our enterprises – we have to take care that there is a willingness among our entrepreneurs to set higher goals and we must encourage our workers to achieve higher standards. We must be glad if we reach somewhere, but it is dangerous if we think that this "somewhere" is good enough. There should be no long-term states of satisfaction.