

# FICE

## Foreign Investors' Council in Estonia

### **ESTONIA, AN IDEAL ENVIRONMENT TO OPERATE IN OR FROM?**

#### **FICE's policy priorities 2011-2015 for improvement of the climate for foreign investments**

#### **Recommendations to the Estonian Government**

April 2011

The start of the tenure of the new Estonian Government sees the opportunity and need for focus on the future of business related policies.

In this, the Foreign Investors Council in Estonia (FICE), representing about 500 member companies, would like to actively participate. FICE likes to bring forward to your attention some of the most important issues and challenges, supported by a recent survey conducted amongst the members of the FICE organization.

**FICE's policy priorities 2011-2015** reflect the points that were brought to the attention of the leaders of the Estonian Political parties on March 11.

FICE identifies Estonia's opportunities for increased foreign direct investments (FDI) to be first and foremost in optimizing settlement conditions for SME's that either serve the Estonian market or that choose Estonia as an operational base from which to serve clients in third countries. Manufacturing, subcontracting but above all the service industries provide opportunities. Estonia needs above average growth to climb the wealth ladder and this growth is to be found mainly through an enhanced international orientation.

Estonia has to see itself as one of many options for FDI and in this competitive arena has to provide the best possible business environment to convince foreign investors to choose it over other options.

From several topics under discussion FICE has identified three main areas that, in our opinion, are critical to achieve greater success in attracting a sustainable inward flow of investments and to realize growth of the Estonian economy in the coming years:

- 1. Taxation**
- 2. Education and Labor**
- 3. Public and Private Governance**

#### **1. Taxation**

- Maintaining the current simple taxation system with its flat rate and exemption of taxation on re-invested profits, which is very attractive to foreign investors. We cannot stress enough that this provides a unique competitive advantage to Estonia. Other countries with more complicated systems will have great difficulty copying Estonia's proposition. The continuation of the simple tax regime is among the highest priorities for the 500 FICE members.
- We advocate a cap on social tax. The cap should be set at a level not less than 3 times and not higher than 5 times the average gross salary. With a cap on social tax Estonia will be able to attract and keep human talent. To compete successfully in the international arena Estonia needs all the brains it can get.
- The existing tax system currently regards certain company costs wrongly as taxable benefits to staff members. The current rules penalize companies providing education and training to their staff. This is an anachronism in a modern Europe where governments are committed to giving permanent and lifetime learning opportunities to citizens. Companies are prepared and willing to invest in their employees' education – such investments are to be seen as costs, not as benefits. A similar anomaly exists in deductibility of costs for travel, hotel stays and other expenses related to business trips in Estonia and abroad. Tax-exempt expenses have not been raised for nearly a decade – prices in Estonia and abroad, on the other hand, have. In order to export more and expand business relationships, travel should be seen as an essential part of daily business costs. FICE strongly suggests treating both mentioned categories as company costs without restrictions and without fringe benefit taxation.

#### **2. Education and Labor**

- FICE likes to emphasize that successful and sustainable FDI is foremost about knowledge transfer, talent and best practice. Only secondarily is FDI about money invested. This calls for an open environment where foreign talent is actively welcomed to work and live in Estonia, to share with the Estonian community and vice versa. In other words an open attitude towards the international community is a prerequisite for successful FDI. In practice this calls for an active policy where Estonia welcomes foreign talent to settle and participate in Estonia's development. Such policy should include relaxation of visa and work-permit requirements for talent from EU and non-EU countries alike. Such policy should also consider soft aspects, making foreign talent feel at home and at ease.
- Education is of great importance for successful development, especially if a country has limited national resources and relies most importantly on its human capital, as is the case in Estonia. So far the position of Estonian governments has been that education is foremost the task of public or private institutions without too much government guidance. FICE believes that this should change and that government should claim a larger say and also responsibility in educational programs. Estonia's educational system is important for the future success of the country. Policies and decisions with a long time horizon are too important to be left to the private or semi public sector which usually does not have the capacity to look further ahead than 5-10 years.

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- FICE members ask themselves where are the plumbers? Where are the locksmiths? The train drivers? In our opinion too much value is placed on academic education. This translates into undervaluation of all sorts of crafts that a society needs, to be well rounded and properly functioning. In much of Western Europe well-qualified plumbers, to name just an example, enjoy a serious and respected status.
- Foreign investors miss an active interest and curiosity from the side of vocational and academic institutes of education for the educational needs of employers. Dialog is missing probably also because the revenue incentives are not properly aligned. The ultimate goal of any education should be for the successful employment of students in a profession she or he has studied towards. Currently, this is not one of the elements that educational institutes are rated on. We signal the need for a drastic improvement of cooperation between employers and educational institutions.
- Vocational education could greatly benefit from a closer cooperation with employers in their field of activity if Estonia were to adopt the so called dual educational system that is prevalent in many of the German speaking countries in Europe. Such a dual system consists of a quality-controlled effort by the employer teaming up with the vocational institute to provide a long-term work/study experience to the student. The result would be a more profound practical transfer of professional knowledge to vocational students and a better way for students to get accustomed to the day-to-day reality of the profession that they have chosen for. Implementation of such system would help to reduce the number of drop-out students and likely will sharpen the purpose of the educational institution.
- Private universities in Estonia have rather a high market share in academic education. Some of the faculties do not live up to academic standards of university education. In order to protect academic standards we encourage government to take a more active role in the qualification of higher institutes of education.
- Education through the medium of English language must be available to Estonians and foreigners. In order to attract foreign talent to work in Estonia for the short, medium and even longer term a speedier implementation of the international baccalaureate at all grades plus accessibility thereof to the international business community is required in the Estonian state school system.

### 3. Public and Private Governance

- FICE was surprised to learn how omnipresent is the need for improvement in governance its members' mentioned in a recent survey. While Estonia as an OECD member might have a relatively good reputation compared to some of the other emerging economies, the standards on governance both in the public and the private sector need to be significantly raised.
- Local governments and public institutions often lack the quality, capacity and willingness to handle requests for permits in a speedy and correct way. There is not much to be gained from the fact that you can establish a company in a couple of minutes while it then takes three years to get a building permit. There is too much red tape. We recommend creating an active and measurable government policy to cut red tape and to bring procedures up to speed.
- Attention should be given to clearly drafted public procurement tenders.
- There is a sense that corruption and fraud cases are currently handled in a too opaque a manner. A transparent method for dealing with corruption and fraud cases should become a priority.
- Realization of the long planned administrative reform should get highest priority. The merging of communities on a local level is necessary to increase efficiency and competence.
- FICE calls for continued attention for the damaging effect that illegal tax avoidance and the grey economy and its tolerance by public institutions and administration have on the

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competitiveness of those companies that go by the book. Tax avoidance has not only a damaging effect on competitiveness, it might even block the market for honest players. FICE has the impression that there are not enough consequences with regard to tax avoidance. Companies can still quite easily file for bankruptcy, without paying VATs and social taxes and then immediately restart the same business with a new company.

- The governance of state owned companies and the transparency of the role of their board members should be improved. As government owned companies play a significant role in the Estonian economy, we advocate a clear ownership policy. We encourage the government to implement the recommendations of OECD and Baltic Institute of Corporate Governance in this area.
- FICE calls for a more effective and swift judicial system, especially with regards to business disputes, which take much too long to resolve.

We urge the Estonian Government to take FICE's policy priorities for the improvement of the environment for foreign investments in Estonia into consideration.

FICE looks forward to the continuation of the tradition of open discussion of its policy priorities with the Estonian Government and the relevant Ministers.

We look forward to scheduling meetings during the coming months and express our hopes for a fruitful discussion and active discourse.

On behalf of FICE,



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FICE Chairman  
Holland Business Club in Estonia

Paal Aschjem  
FICE Vice-Chairman  
Norwegian-Estonian Chamber of Commerce

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## **About FICE**

FICE – The Foreign Investors' Council in Estonia, was launched in August 2008, as group acting on behalf of 9 chambers of commerce through contacts with the Estonian Government and Estonia's Governmental bodies.

Pioneering FICE members include the Austrian, British-Estonian, Danish, Finnish, German-Baltic, Holland, Norwegian and Swedish Chambers of Commerce, Business Clubs and Marketing Offices in Estonia. The American Chamber of Commerce in Estonia is a FICE member with observer status.

Together, the nine countries represented in FICE account for more than 80 % of the total foreign direct investments in Estonia [source: Eesti Pank] FICE members represent nearly 500 companies active in Estonia.

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