

BTI 2012 | Estonia Country Report

Status Index	1-10	9.28	# 5 of 128	
Political Transformation	1-10	9.55	# 5 of 128	➔
Economic Transformation	1-10	9.00	# 5 of 128	➔
Management Index	1-10	7.41	# 3 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

More on the BTI at <http://www.bti-project.org>

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Key Indicators

Population	mn.	1.3	HDI	0.835	GDP p.c.	\$	20615
Pop. growth ¹	% p.a.	0.0	HDI rank of 187	34	Gini Index		36.0
Life expectancy	years	75	UN Education Index	0.916	Poverty ³	%	<2
Urban population	%	69.5	Gender inequality ²	0.194	Aid per capita	\$	-

Sources: The World Bank, World Development Indicators 2011 | UNDP, Human Development Report 2011. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

The profound economic crisis of 2008 – 2009 had a somewhat paradoxical effect on Estonia's ongoing transformation. As a consequence of the worldwide shock, the country not only strengthened its political stability (re-electing its incumbent prime minister), it also took a major economic step forward by joining the eurozone (completing all of the inflation targets and government debt requirements this involved). The country achieved this by enacting several rounds of austerity measures (albeit somewhat late into the crisis). These had a biting effect on the population, especially those who had been part of the country's housing bubble and now faced sizeable mortgages. But the reforms had had enough time to take effect by early 2011, when voters returned the dominant political parties to power and no new challengers emerged. International investor confidence and political credibility remained strong.

Not all of the country's problems were, of course, solved. The integration of the Russian-speaking minority remained a hot issue, as the government began introducing more Estonian-language teaching in Russian-language secondary schools, while at the same time scaling down integration policy. Low levels of political participation among minorities also remained worrisome. Estonian civil society strengthened, as evidenced by a number of civic events that took place during 2009 – 2011. However, consultative mechanisms with government as well as policy coordination within government had room for improvement.

History and Characteristics of Transformation

Estonia's process of political and economic transformation began shortly after the advent of Mikhail Gorbachev's perestroika and glasnost policies within the Soviet Union. Although initially reform was resisted by an old guard in the Estonian Communist Party, civic and

intellectual leaders used the opening to mobilize the population on a range of grievances, including industrial pollution, the constant influx of mostly ethnic Russian immigrants to the republic, concomitant Russification and economic hardship. These reform demands soon swelled into a movement demanding the restoration of outright independence. In March 1990, the republic declared its formal intention to re-establish independence; its actual release from the Soviet Union came in August 1991.

Overall, it is important to note that Estonia's democratic transformation has been characterized by a unique political doctrine known as legal restoration. According to this principle, Estonia has never seen its independence as the beginning of a new era of statehood, but rather as a restoration of the same statehood based on a legal continuity from the pre-1940 republic. This approach contributed much to legitimizing democracy as a way of government and to creating a momentum for the quick adoption of a new constitution in 1992. At the same time, this principle was used to exclude from automatic citizenship all post-1940 settlers to Estonia (mostly ethnic Russians), because under legal restorationism they were defined as "illegal immigrants from a foreign occupation." They were made eligible for naturalized citizenship, but only if they passed an Estonian language and civics test. This has meant that Estonia began its renewed independence with a sizeable population (20%) of non-citizens. This in turn profoundly affected the structure of Estonia's early political cleavages. It allowed the country to be far more pro-Western than might otherwise have been the case. At the same time, minority integration has been an important political issue throughout the last 20 years, but progress has been slow. Only about half of Estonia's minority population are citizens of Estonia, the remainder are either Russian Federation citizens or are without any citizenship.

Economic transformation was also affected by legal restorationism, since the doctrine helped to recall the country's market economy from the interwar period. However, such formalism also led to extensive property restitution, or the return of Soviet-nationalized property, which in turn became a long bureaucratic process, lasting more than 15 years. In terms of economic activity, Soviet-era heavy industry was largely abandoned (with the exception of oil shale mining for electricity production), while export-oriented service industries, biotechnology and IT industries were strongly promoted. As a result, by the mid-1990s the country emerged from its initial post-communist slump and began a 10-year economic boom, posting growth rates of 10% – 11%. In hindsight, there were two related factors that explained Estonia's successful transition management: A unique degree of political readiness for decisive change, and geographic proximity to the Nordic countries, which provided much needed economic and political contacts. This combination of "push" and "pull" factors helped Estonia not only in relation to the rest of the former Soviet Union, but also in comparison to the other Baltic states. Obviously, this national consensus on transition largely excluded the Russian minority. But despite the formalism of restorationism, most policies were remarkably innovative and future-oriented. Estonia tackled "post-modern" developments and phenomena such as democratic apathy, EU skepticism, de-industrialization, globalization and an aging population far earlier than most other post-communist societies. Conversely, political centralism, regional policy and ethnopolitics remained rather conservative.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 10 (best) to 1 (worst).

Transformation Status

I. Political Transformation

1 | Stateness

Question
Score

The Estonian state has a clear monopoly on the use of force in the country. There are no extra-legal forces or threats to the country's territorial integrity. There is an ethno-regional cleavage in that the northeast of the country (mainly the county of Ida-Virumaa) has an ethnic Russian majority. In the early 1990s, some fears were raised that this region could become secessionist in favor of Russia. But this threat quickly dissipated as Estonian statehood became more stable and the economy began to improve.

Monopoly on the
use of force
10

Estonia defines itself as an Estonian nation-state, as for example in the preamble of the constitution, which declares that the Estonian state "shall guarantee the preservation of the Estonian nation, language and culture through the ages." This has been controversial at times among the country's Russian-speaking minority of roughly 30%, who have expressed a desire for more recognition as a constituent ethnic group in the state via, for example, the acknowledgement of Russian as a second official language. Moreover, the ethnic cleavage has overlapped considerably with citizenship status, because shortly after re-independence Estonia adopted a restrictive citizenship policy, which accorded automatic citizenship only to those who were citizens of the pre-1940 republic or their descendants. Individuals who had settled in Estonia during the Soviet occupation or were descendant of such people could only apply for naturalized citizenship, which involved passing a language and civics exam. Because the vast majority of Estonia's Russian-speakers came to the country after 1945, some 85% of the country's minority population was initially without any citizenship. In numerical terms this amounted to some 400,000 out of a total population of around 1.4 million.

State identity
8

In the years that followed, perhaps a quarter of these people resettled in Russia, while the remainder stayed in Estonia. Of these, roughly a third gradually fulfilled the naturalization requirements and successfully acquired Estonian citizenship,

while around another third took Russian Federation citizenship. A final third did nothing, becoming “persons with undefined citizenship” or essentially stateless (since the Soviet Union had disappeared). These people retained full residency rights and social welfare benefits, but could not vote in national elections, work in the civil service or be members of political parties. By January 2011, roughly 85% of Estonia’s residents were citizens of the country, 7.2% were Russian Federation citizens and 7.3% were stateless. Naturalization had succeeded since 2002 in reducing the number of stateless people in Estonia by over 40%. However, these rates began to slow towards the end of the first decade of the twenty-first century. In this respect, the citizenship legacies of Estonia’s legal restorationist doctrine are only slowly being overcome.

The Estonian state is wholly secular and there is no influence on the part of organized religion. While there are two main religious movements in the country, Lutheranism and Russian Orthodoxy, the percentage of people professing a religious affiliation (according to the 2008 European Social Survey) was just 27%. This figure has changed little during the entire transformation period.

No interference of religious dogmas
10

In the years following Estonia’s accession to the European Union, the country’s basic administration has continued to function well. All of the major branches of government are operational, including the court system, tax administration, local government and the education system. As a small country, Estonia often suffers from a lack of administrative capacity and personnel to be able to specialize its civil service in all fields. However, this has not hindered its basic governance functions. During 2010 and early 2011, Estonia’s basic administrative capacities were proven once more when it successfully introduced the euro as its national currency, carrying out all of the necessary practical planning for such a major transition.

Basic administration
10

2 | Political Participation

Estonia’s elections (at all levels) have consistently been deemed free and fair. These include (since 1992) six parliamentary, six municipal and two European elections. During the early 1990s, Estonia’s restrictive citizenship policy limited the number of eligible voters to roughly 60% of the voting-age population. However, by 2011 this figure was up to 86.5% thanks to increased naturalization. Moreover, Estonia allows non-citizens to vote in local elections, where the entire voting-age population has been able to participate.

Free and fair elections
9

All of the elections have featured a wide array of political parties and electoral platforms. Since 1999, the number of parties participating in national elections has stabilized between nine and 12, with around five or six gaining representation in parliament.

Estonia is a parliamentary democracy in which the prime minister is nominated by the president, but is appointed into office by and is accountable to a majority of the parliament. There are no veto players outside the constitutional system. While business groups are well organized and individual industrialists hold considerable political sway, they do not hinder the state's effective power to govern.

Effective power to govern
10

Freedom of assembly and association are guaranteed in the Estonian Constitution and by supplementary legislation. The Public Assembly Act stipulates formal rules for organizing outside gatherings, while the Non-Profit Associations Act regulates the registration of NGOs, foundations and other association. All of these procedures are within the basic democratic order.

Association / assembly rights
10

The constitution guarantees freedom of expression and the country also has freedom of information legislation in place. In January 2011, the media landscape was diverse with five national TV channels (two public, three private; all Estonian language), four national Estonian-language dailies, one Russian-language daily, two Estonian-language weeklies and four notable Russian-language weeklies. Many of the outlets were either partly or wholly foreign-owned, such as the Estonian-language daily Postimees (controlled by the Norwegian concern Schibsted), the business daily Äripäev (under the ownership of the Swedish Bonnier group) or the private television station TV3 (operated by Viasat). The blogs and other social media websites represented an additional and increasingly important realm of free expression.

Freedom of expression
10

In early 2010, a controversy did erupt, however, when the ministry of justice proposed a series of legal amendments with the aim of strengthening the right of journalists to protect their sources. In particular, the government claimed that it was time that Estonia adopted a number of European legal norms in this field, instead of relying purely on self-regulation within the media. The original draft legislation, however, contained a number of exceptions, under which legal authorities would be given the right to force journalists to reveal their sources. These included instances in which criminal investigations were still pending. Several private media outlets opposed the amendments, with newspapers actually publishing a blank front page or editorial column as a sign of their protest. Media representatives also decried an amendment, which would allow authorities to impose pre-emptory fines on media outlets found guilty of libel or slander. During the rest of the year, parliament attempted to hold consultations with journalists' associations and media companies on the matter, and certain compromises were found. But in November the amendments were passed despite continued objections from some observers.

3 | Rule of Law

The Estonian constitutional order is founded on a classical parliamentary system of checks and balances, in which the prime minister depends on a parliamentary majority to stay in office. The president serves the function of balancer, having the right to nominate, but not dismiss the prime minister. Although the president is formally the head of state, he is indirectly elected either by the parliament or a special electoral college. The president can veto laws, but parliament can also override any veto with a simple majority, at which point the president can only appeal the law to the constitutional review chamber of the Supreme Court. Estonia's legal chancellor has an additional function as an overseer, and can challenge the constitutionality of any legal act at either national or local level. If the authority whose act has been challenged by the legal chancellor continues to stand by its legislation, the legal chancellor can likewise appeal to the constitutional review chamber. Lastly, the legal chancellor performs a further role as the ombudsman to whom average citizens can turn if they feel their rights have been violated by government officials. All of these constitutional safeguards have been actively used since 1992 when the new constitution was adopted.

Separation of
powers
10

Estonia's judiciary is comprised of three tiers. Four county-level courts serve as the first instance and hear all criminal and civil affairs. In addition, two administrative courts operate at this tier to deal with administrative law. At the circuit level, two appeals courts exist to hear cases in cassation, while at the highest level the Supreme Court adjudicates all final appeals. The Supreme Court includes amongst its four sub-divisions the constitutional review chamber, which hears special appeals directly from the lower courts, the president, the legal chancellor, a municipality or single individuals, concerning constitutional challenges to any legal act. In this respect, Estonia does not have a separate constitutional court; however, if the constitutional review chamber reaches deadlock on a case, it can refer the matter to the full Supreme Court.

Independent
judiciary
10

In terms of judicial independence, the issue of financing for the judiciary has been a controversial topic for many years. Whereas the Supreme Court has always been treated as a constitutional institution and therefore has a separate segment of the national budget, financing for the lower courts has been set by the ministry of justice, a fact which many observers have argued could potentially make the judiciary dependent on the executive. In 2008, the minister of justice formed a working group (chaired by Chief Justice Märt Rask) to redraft the Courts Act in order to find a better financing scheme. The group completed its work in December 2009, handing over to parliament an entire package of proposed amendments, including the creation of an independent administrative agency for the judiciary.

However, within a few weeks of being made public, the entire reform came under sharp criticism from no less than 12 of Rask's colleagues on the Supreme Court bench. The justices denounced in particular a proposal to give justices and judges higher up in the system the duty to assess the performance of colleagues beneath them. Indeed, under Rask's proposals even the chief justice would be made subject to review by the president of the republic, and if need be, the president would have the right to propose to parliament that a new chief justice be appointed from the existing Supreme Court justices. Rask defended the idea as establishing a system of accountability even for the highest judicial official in the land. However, critics pointed out that a potential constitutional conflict lay in waiting, since under Estonia's system of constitutional review, the president is one of three institutions allowed to appeal legislation to the constitutional review chamber, where the chief justice presides. The observers argued that if, for example, the president were to lose a number of appeals, he/she could decide to accuse the chief justice of incompetence and thereby try to remove his opponent in a politicized atmosphere. These controversies therefore delayed passage of the reform throughout 2010. By year's end, parliament abandoned the effort entirely, although this meant that the issue of judicial financing was also scuttled.

For years Estonia has been widely cited as one of the least corrupt countries in post-communist Europe. Large-scale corruption has been rare and only 4% of respondents in a 2010 ministry of justice survey reported having paid a bribe over the last year. At the same time, 74% of businesspeople admitted to having offered some kind of favor to others as part of their business activities. Moreover, a growing number of Estonians (68%) believed that corruption continues to be a problem in the country, in particular in terms of paying bribes to avoid fines or other punishment.

The prosecution of high-level officials for corruption has received much attention since 2007, when the trial of former environment minister and leader of the People's Union Party (PUP) Villu Reiljan began. Reiljan resigned as minister in late 2006, when he was accused of negligence in the oversight of a number of land swaps organized by his ministry to expand national conservation areas. Under the scheme, real estate developers were able to exchange valuable plots of land in downtown urban areas for rural tracts that had often been appraised at much lower levels. Reiljan's failure to keep an eye on this activity eventually led to further accusations by Estonia's security police board that Reiljan had been directly involved in soliciting bribes from real estate developers for the sale of state properties. The scandal soon came to engulf Reiljan's party colleague and former Agriculture Minister, Ester Tuiksoo, for her role in apparently trying to engineer a move of her entire ministry into a building run by Merko Ehitus, a major construction and real estate company, again apparently for a bribe.

Prosecution of
office abuse
9

In May 2009, a lower court found Reiljan guilty of the main bribery charge. During the next year Reiljan appealed the conviction all the way up to the Estonian Supreme Court, where he demanded that key audio recordings allegedly proving he solicited a pay-off be declared inadmissible on technical grounds. The high court agreed, however, it noted that there was enough other evidence to allow the 27-month suspended sentence to stand. In a show of continued determination, Reiljan vowed to petition still further to the European Court of Human Rights. However, his political career had long since ended. Furthermore, his once 10,000-member strong PUP rapidly started to crumble, scoring less than 2% in during local elections in 2009 and eventually splitting up into numerous different factions.

Judicial corruption has also been a target of Estonian law enforcement. In 2010, three judges were either convicted or arrested for swaying court decisions or releasing sensitive information in return for money. Two of them were in northeastern Estonia, where legal experts have long pointed to problems of professionalism among judges.

Estonia's constitution bans discrimination on the basis of nationality, race, color, sex, language, geographic origin, religion, political or other opinion, property or social status. The country's legal authorities uphold these rights, and furthermore, since October 2005 Estonia has had a gender equality and equal treatment commissioner and further legislation in place to monitor equal rights between men and women. The commissioner has the power to investigate suspected cases of discrimination and facilitate their resolution in the courts where necessary.

Civil rights
10

4 | Stability of Democratic Institutions

Estonia's democratic institutions have been performing effectively, even during the period since the country's accession to the European Union in 2004. Institutional conflicts have been kept to a minimum or have been part of the general system of checks and balances (e.g., vetoes by the president or constitutional disputes resolved by the Supreme Court).

Performance of
democratic
institutions
10

Compared to other post-communist countries in Europe, Estonia has had an average level of government stability. Since 1992, it has had 13 cabinets, each one lasting an average of 1.5 years. Moreover, no cabinet has ever survived a complete parliamentary term. In 2009, for example, the cabinet of Prime Minister Andrus Ansip was reconfigured (after two years in office) when the Social Democratic Party (SDP) was thrown out of the coalition. Formally, Ansip did not need to seek re-installation into office; thus in legal terms his government was seen as continuous across the full four-year parliamentary term. However, because his

political basis shifted (he continued for two years essentially as a minority government), it was still seen as a new cabinet.

From 2009 – 2010, relations between the national and local governments were strained because of the economic crisis and political rivalries. In 2009, parliament decided to redistribute more tax revenue from the local level to the central administration in order to cover budget deficits at the national level. As a retaliatory move, the Tallinn city government (under the control of the opposition Center Party (CP)) adopted a number of alternative tax measures, which the national parliament later outlawed. These partisan squabbles have also handicapped efforts to carry out important civil service and local government reforms.

Since the adoption of the 1992 constitution, there have not been any challenges to the legitimacy of Estonia's democratic institutions. All relevant political and social players accept the democratic order.

Commitment to
democratic
institutions
10

5 | Political and Social Integration

After going through a period of flux during the 1990s, Estonia's party system has become more and more consolidated since 2000. Fragmentation has begun to decrease and political cleavages have become more distinct. During the 2011 elections, only nine parties fielded candidates and only four parties made it into parliament. The number of effective parliamentary parties reached a low of 3.8 (from a high of 5.9 in 1992). The percentage of "wasted votes," or votes given to a party that did not make it into parliament, was high at 10.5, but had been as low as 4.4 in 2007.

Party system
9

Ideologically, the system has coalesced around three poles: a national-conservative one (led by the Pro Patria & Res Publica Union, PPRPU), a market liberal one (led by the Reform Party, RP), and a center-left one (anchored by the CP, but also occupied by the agrarian PU). The SDP (formerly the Moderates) has also long professed itself to be a center-left party but has refused to cooperate with the CP, because of the domineering nature of the CP's long-time leader, Edgar Savisaar. This has caused the SDP to agree at different times to government coalitions with the PPRPU and the RP, although differences with these parties over policies necessary to stem the 2008 – 2009 recession caused Prime Minister Andres Ansip to throw the SDP out of the governing coalition in 2009.

Despite having a large Russian-speaking population (roughly 30%), no Russian parties have been represented in the Estonian parliament since 2003. Rather, ethnic Russians have increasingly supported the CP, which has co-opted many prominent Russian-speaking leaders into its ranks. In 2007, a new Green Party (GP) gained six

seats in the parliament; however, in 2011 it failed to cross the parliamentary threshold.

The key to the Estonian party system has been the RP, which has deftly succeeded in playing the partner at different times to both the PPRPU and the CP. As a result, it has been a member of the government continuously since 1999, and for seven of those 12 years it has even led the cabinet. Indeed, despite governing throughout the 2008 – 2009 financial crisis, the party actually saw its electoral support increase following the 2011 election from 27.8% to 28.6%. It has become the dominant party in Estonia, with the CP second, the PPRPU third, and the SDP fourth. In early 2011, the future of the PU (once Estonia's largest party by membership) was unclear, since the party garnered just 2.1% in the last election and was undergoing a leadership and identity crisis since its long-time leader Villu Reiljan was arrested on corruption charges.

The one major weakness of the Estonian party system is that despite garnering regularly 20% – 25% of the vote, the CP has increasingly come to be seen as a pariah party, with which the other parties refuse to have any major dealings. Although part of this ostracism was due to some questionable practices by the CP's leader, Edgar Savisaar, it has polarized Estonian politics and limited the scope for real competition.

The participation of interest groups in Estonian policy-making and societal affairs is balanced though not very structured. A number of social groups are organized (pensioners, students, disabled, women), but trade unions, for example, are relatively weak, with just 10% of Estonians being members. In the 1990s, the Estonian government played a role in organizing “tripartite” negotiations with employers' federations and trade unions, but later it stepped away from this process and left it to the other two parties to reach their own compromises. The government now only enforces the minimum wage agreements reached by the employers and employees. As part of its EU accession, the government has formalized some of its procedures for consulting with interest groups by adopting a code of best practice. However, this input is often sought only in the opening stages of legislative work; the level of consultation also varies greatly across ministries and government agencies.

For more than a decade a range of surveys has shown that over half of the Estonian population is either “generally satisfied” or “very satisfied” with the way democracy works in the country. In the 2008 European Social Survey, this figure was 53.5%. The same survey showed that only 25% thought that rule by a single strong leader would be better than by parliament or political parties. Trust in the main political institutions (parliament, parties, politicians) was still problematic

Interest groups

8

Approval of
democracy

9

(less than 50%), but trust in other institutions such as the legal system was high (58%). The police enjoyed particular confidence, with 77.6%.

Estonia's voluntary organizations fall mainly into two groups. As of June 2010, roughly 40% of the country's 30,000 registered citizen associations were apartment cooperatives. These were created during the years of housing privatization, and although they mostly dealt with simple management issues, they have served as an important grassroots locus of civic interaction and mutual self-help. Estonia's remaining non-profit associations span the entire range of social activities and conform to the traditional definition of civic association. In 2009, the USAID's NGO Sustainability Index gave Estonia a ranking of 2.0, which was the highest score for any post-communist country. Still, surveys have shown that more than 75% of Estonians do not participate in any voluntary or charitable organizations, and civic organizations employ only around 4% – 5% of the labor force.

Social capital
9

II. Economic Transformation

6 | Level of Socioeconomic Development

In its 2010 Human Development Report, the United Nations ranked Estonia 34 in the world with an HDI of 0.812, ahead of Poland and the other two Baltic states, but behind the other Visegrad countries in Central Europe. Calculations of Estonia's Gini coefficient varied in terms of their most recent data, but the CIA's World Factbook reported a coefficient of 31.4 for 2009, which was a considerable improvement to the score of 37 calculated for 1999. According to the Estonian statistical office, the percentage of people living below the poverty level rose in 2008 to 19.7% (following an average of 18% earlier in the decade). For 2009 the agency reported a sharp drop in this figure to 15.8%, but this was caused by the fact that income levels decreased overall in Estonia during the recession, causing the statistical threshold for poverty to also decline. As a rule, ethnic Russians and other minorities showed higher rates of poverty, as well as residents in northeast Ida-Virumaa county, where about 40% of Russians live. Another at-risk region was the southern county of Valga, where poverty was more than twice the figure in the capital, Tallinn.

Question
Score

Socioeconomic
barriers
8

Unemployment during the first quarter of 2011 stood at 14.4% and was falling. However, over half of these people were long-term unemployed (i.e., jobless for over a year).

Economic indicators		2007	2008	2009	2010
GDP	\$ mn.	21659.1	23566.0	19265.8	19216.6
GDP growth	%	6.9	-5.1	-13.9	3.1
Inflation (CPI)	%	6.6	10.4	-0.1	3.0
Unemployment	%	4.7	5.5	13.7	-
Foreign direct investment	% of GDP	12.7	7.4	9.9	8.0
Export growth	%	1.5	0.4	-18.7	10.7
Import growth	%	7.8	-7.0	-32.6	8.8
Current account balance	\$ mn.	-3503.2	-2356.3	740.8	673.2
Public debt	% of GDP	3.7	4.6	7.2	6.6
External debt	\$ mn.	-	-	-	-
Total debt service	\$ mn.	-	-	-	-
Cash surplus or deficit	% of GDP	3.1	-2.2	-1.3	-
Tax revenue	% of GDP	16.6	15.1	17.4	-
Government consumption	% of GDP	16.7	19.5	22.0	20.6
Public expnd. on edu.	% of GDP	4.8	-	-	-
Public expnd. on health	% of GDP	5.2	6.1	7.0	-
R&D expenditure	% of GDP	1.11	1.29	-	-
Military expenditure	% of GDP	2.1	2.2	2.3	-

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

7 | Organization of the Market and Competition

Estonia has often been cited as one of the most open and liberal economies in the post-communist world. There are no price controls, the Estonian kroon (up until its replacement by the euro in January 2011) was fully convertible. There are equal opportunities for all market participants and profits may be freely used and transferred.

Market-based
competition
10

Estonia established a competition board in 1993 with the main function of enforcing the country's Competition Act, originally adopted that same year. The act (as later amended and together with a number of supplementary government decrees)

Anti-monopoly
policy
10

defines and establishes sanctions for all “agreements, concerted practices and decisions” among firms that restrict free market competition. In 2008, the board was re-organized into the Competition Authority, as it was merged with a number of other oversight institutions. During the 2008 – 2009 recession, the authority noted a sharp decline in the number of company mergers, easing pressures on monopoly policy. The authority has also played an active role in monitoring utility prices (e.g., water, natural gas, heating, gasoline).

Estonia spurred much of its economic growth during the 1990s with a very liberal, tariff-free foreign trade policy. The country came under the umbrella of the EU’s general foreign trade regulations following accession in 2004, but it has continued to maintain an open economy. This liberalism, of course, became a kind of liability with the global financial crisis of 2008. However, there were no calls for renewed protectionism.

Liberalization of
foreign trade
10

Estonia conforms to all major international banking standards. The Bank of Estonia is a fully independent institution responsible for monetary policy in the country. With Estonia’s accession to the euro in January 2011, the bank became part of the Governing Council of the European Central Bank, thus transferring monetary policy to this higher body. The Bank of Estonia remains responsible for regulatory policy, together with the Estonian Financial Supervision Authority. The latter exercises oversight also in relation to insurance companies, investment firms and funds, as well as the securities market.

Banking system
10

During the 2008 – 2009 financial crisis, Estonia’s banking sector did not suffer any major turbulence since the foreign (mostly Swedish and Finnish) owners of the banks were able to absorb the shock and maintain liquidity. Capital adequacy ratios remained around 20% – 22%. The ratio of non-performing loans (over 60 days) tripled in the space of a year, from 2% to over 6% in September 2009. However, the figure peaked shortly thereafter at 7% and remained around 6% in early 2011.

8 | Currency and Price Stability

Inflation decreased rapidly in 2009 after reaching a high of 10.4% in 2008. In fact the consumer price index turned negative by the end of the year, while the figure for 2010 rose again to 3.0%. With Estonia’s entry into the eurozone, these fluctuations in inflation were expected to stabilize. It was predicted that the aftereffects of the recession would keep wages in check. Estonia’s foreign exchange policy ceased to exist as part of euro accession. However, this was not a major transformation, since the Estonian kroon had been pegged to the German mark (and later euro) since 1992.

Anti-inflation /
forex policy
9

Estonia has maintained an extremely conservative fiscal and debt policy since independence, operating with a surplus national budget in many years and in turn storing that cash in a stabilization reserve. This allowed the government to finance a certain amount of deficit spending in 2008 – 2009 and avoid borrowing on the open market. At the end of 2010, the reserve continued to amount to 9.5% of GDP, although officials acknowledged that this would probably fall in coming years as more investment would be needed. Within the European Union, Estonia had the lowest level of public debt, at just 7.2% of GDP.

Macrostability
10

9 | Private Property

The groundwork for a stable and equitable system of property rights was laid in Estonia during the 1990s when, firstly, an extensive program of property restitution (a return of Soviet-era nationalized property) was enacted, and then a set of laws for the protection of new property was adopted. The courts (including the constitutional review chamber) have adjudicated numerous cases concerning property rights, and these rulings have all been respected.

Property rights
10

Article 31 of the Estonian Constitution states that Estonian citizens shall have the right “to engage in enterprise and to form commercial undertakings and unions.” In terms of economic policy, private companies are viewed as the primary engines of economic production. Most of the country’s major government assets were privatized during the 1990s. The only major reversal of this principle was a state buyback of Estonian Railways from a group of private investors in early 2007 in order to better modernize the rail system and retain strategic control over a sector of the economy linked to transit trade and economic security vis-à-vis Russia.

Private enterprise
10

10 | Welfare Regime

Estonia’s welfare regime is relatively comprehensive, encompassing health insurance, unemployment insurance, old-age pensions, family benefits and disability benefits. At the same time, the level of payments is comparatively modest given the country’s lower level of economic development. During the recent recession, the government was forced to raise the unemployment insurance tax considerably (to a total of 4.2% on monthly wages) in order to continue financing the payment of benefits. It also suspended for a year and a half state contributions to the second pillar of the pension system. These were set to resume gradually in 2011 – 2012.

Social safety nets
9

For more than a decade statistics in Estonia have shown a gap of some 25% between what men and women earn in terms of average hourly wage. This disparity has repeatedly received public attention, but is often discounted as an inevitable

Equal opportunity
9

consequence of the market. While Estonia has both a gender equality department (within the ministry of social affairs) and a gender equality commissioner, there have been few active measures to ameliorate these differences. During 2008 – 2010, the ministry of social affairs ran a wide-ranging program to promote gender equality, but for the most part its activities were focused on simply raising awareness of the issue.

Equal opportunity has also been an issue for Estonia's Russian-speaking minority, for whom lack of Estonian language knowledge has often proved a barrier to well-paid employment or higher career positions. The government's minority integration program has tended to focus on providing language and other skills training, but there has been little focus on pro-active measures to expand minority opportunity.

11 | Economic Performance

Together with its Baltic neighbors, Estonia posted one of the most severe economic declines in 2009, -14.1%. Unemployment more than doubled to 13.8%, while important sources of tax revenue (social taxes, VAT, personal income taxes) all fell by more than 10%, despite a January 2009 hike in VAT from 18% to 20%. The government was able to avoid major deficit spending by drawing on reserves stored up during earlier years of prosperity. However, major cuts in spending also had to be made.

The crisis did allow Estonia's long-chronic current account deficit to turn positive in 2009 and 2010, when imports declined. However, it was unclear how much Estonia's export industries would be able to use the crisis to strengthen their competitiveness after the crisis. Growth returned in 2010, posting 3.1% with slightly higher rates expected for 2011 and 2012. But the economic climate was still wary, as unemployment remained high and imports began creeping up again.

Output strength
8

12 | Sustainability

Estonia has in place an environmental protection strategy for the years 2007 – 2013, which encompasses areas such as the sustainable use of natural resources, the minimization of pollution, the preservation of biodiversity and the control of climate change. In 2009, Estonia continued to raise the rates of excise taxes on gasoline and natural gas to promote conservation. Investments into wind technology were also being made, but over 90% of the country's electricity continued to come from the burning of oil shale, a local natural resource. The high pollution content of this energy source and its limited availability (perhaps only another 40 – 50 years-worth of raw material remain) have raised questions about the development of alternative sources, including nuclear energy. Awareness about environmental

Environmental
policy
8

issues was raised partially by the fact that a Green party entered parliament in 2007. However, it remained in the opposition, suffered a severe split and four years later fell out of the legislature.

Throughout the first decade of the twenty-first century, Estonia increased yearly state spending on education by an average of over 10%. Yet, as a percentage of GDP this amount remained around 5%, since at the same time GDP itself expanded rapidly. In 2008, spending on R&D reached 1.28% of GDP, continuing a steady upward trend. During the 2008 – 2009 recession, education and research spending was kept steady, reflecting a commitment by the government to maintain this key area of investment in the economy. This meant that in 2009 Estonia's comparative indicators improved considerably: R&D as part of GDP went up to 1.42% and the ratio of people employed in science and research rose. However, these were again deceptive, since during this period both GDP and employment contracted.

Education policy /
R&D
9

Transformation Management

I. Level of Difficulty

Estonia's structural constraints are low. Its population is well educated (with a high UNDP Education Index) and it has no significant geographic limitations. Although the global financial crisis set back economic development for some time, the country's future prospects are good and social problems are manageable. In this respect the main structural challenge involves successfully adapting the structure of the economy and of the workforce toward more value-added and efficient production.

Structural
constraints

2

By late 2010, the number of officially registered HIV-infected persons in Estonia had topped 7,600, of whom over 300 had developed the AIDS virus. Given Estonia's small population this is a sizeable number. More than half of new infections continued to be in northeastern Ida-Virumaa county, meaning the disease was spreading disproportionately among Estonia's Russian-speaking population. A significant number of diagnosed cases were also in prison.

Estonia's civil society tradition has been improving, thanks to rising standards of living as well as the implementation of specific programs such as the Estonian Civil Society Development Concept and the creation of a special national foundation of civil society meant to support civic associations with grants and advice. With a yearly budget of 18 million Estonian kroons (or €1.15 million), the foundation was able to support dozens of projects and initiatives. For example, the foundation supported 25 NGOs working in the field of social entrepreneurship. It has also worked to maintain a network of regional civil society development centers in order to decentralize outreach and stimulate local initiative. In addition to the foundation (which is under the minister for regional affairs), a second broad-based civic association known as the Estonian Cooperation Assembly also operates under the auspices of Estonia's President. The assembly works specifically in the fields of education, employment, minority issues and population affairs. Thirdly, one of Estonia's oldest post-1991 civic associations, the Network of Estonian Nonprofit Organizations, has become very well established as a support system working specifically with individual NGOs (and their umbrella organizations) to provide training and other services. Lastly, since 2008 a tradition has begun to emerge where people across Estonia are mobilized on May 1 for some kind of major civic

Civil society
traditions

3

action. During the first campaign over 50,000 people joined a common effort to clean up Estonia's forests and countryside. In 2009, some 10,000 people took part in simultaneous discussion groups meant to generate new ideas to tackle social issues in the country. In 2010, over 30,000 volunteers participated in cleaning up public spaces, restoring commemorative sites or promoting environmental protection.

Ethnic minority integration in Estonia was dealt a major blow by the Bronze Soldier crisis in spring 2007. Although the protests lasted less than a week, they were a reminder that many Russian-speakers (particularly young people) feel alienated in Estonian society. Moreover, the conflict showed how the two communities viewed the question of history as well as minority integration in diametrically different ways. Following the crisis, integration suffered another setback, when Prime Minister Andrus Ansip decided to abolish the special post of minister for population affairs, whose portfolio included Estonia's integration policy. Although formally different aspects of this policy were transferred to the education and culture ministries, the political weight of this issue declined noticeably. In the last decade of the twenty-first century, Estonia began implementing a long-awaited policy of increasing the amount of lessons taught in Estonian language at Russian-language secondary schools. The objective was to ensure pupils' knowledge of the national language when they graduate so that they would be better prepared for the job market and for possible university study. While most members of the Russian-speaking community agreed with this broader goal, they remained fearful that the policy would prompt assimilation or that not enough resources would be devoted to really teaching the language. The reform was meant to be gradual. But in early 2011 authorities in the capital Tallinn called for an extension of the deadlines, arguing that the change was being carried out too quickly.

Conflict intensity

3

II. Management Performance

14 | Steering Capability

Long-term policy planning in Estonia has depended on the existence of stable government coalitions. These have generally been from the center-right, including the coalition currently in power since April 2009 between the RP and the PPRPU under the leadership of Prime Minister Andrus Ansip. Admittedly, since 2002 Estonia has experienced shake-ups in its government coalition every two years or so, which has meant that real strategic vision has been limited. However, the fact

Question
Score

Prioritization

10

that the RP and the PPRPU succeeded in winning re-election in March 2011 indicated that strategic policy-making would now take place in some areas.

The economic crisis of 2008 – 2009 put an unprecedented strain on the Estonian government to implement effective crisis management policies. By passing extensive austerity measures in 2009 and 2010 (state spending contracted by over 10%), the government showed it could cope with the challenge. Moreover, there was no notable social unrest or upheaval. Prime Minister Andrus Ansip lost his formal majority in parliament when he forced the SDP out of his government in May 2009. However, he soon found other allies amongst the Greens or independent members of parliament, allowing his coalition to continue to pass legislation.

Implementation
9

Economic crises are a time for policy flexibility and learning. During 2009, Prime Minister Ansip had to relent on several earlier political promises to cut taxes or enhance investment. Instead, he was forced to raise both VAT and personal income taxes. He also pushed through labor reform measures, which raised unemployment insurance charges, but reduced benefits slightly. At the beginning of the crisis, Ansip was criticized for not acknowledging the impending downturn sooner and practicing merely reactive policy-making. However, by early 2011 he could point to renewed economic growth and a tentative feeling of recovery.

Policy learning
8

15 | Resource Efficiency

Estonia's small population puts a premium on the efficient use of its human resources, but it also sometimes makes it difficult to avoid conflicts of interest or decisions motivated by personal relations. Political appointees in civil service are rare; however, ministers have tried at different points in time to replace the director-general (or top civil servant) in their ministry, when they have not seen eye-to-eye politically. The number of political advisers appointed by ministers has also grown.

Efficient use of
assets
9

Estonia's national budget has continually been balanced, and the state debt is the lowest in the European Union. The budget process at national level is transparent, requiring three separate readings in parliament. At local level, however, some municipalities have been less forthcoming. In the capital Tallinn, the left-leaning CP, which has an absolute majority in the city council, has often been accused of drawing up city budgets in secret and then passing them with lightning speed.

One very positive element of efficiency in Estonia has been country's extensive development of e-government services. These include the electronic filing of tax returns, but also the growing use of digital signatures to submit or transfer official documents. By March 2011, this service had been used over 51 million times. In 2007, Estonia became the first country in the world to allow internet voting in a national election. Since then, the practice has continually expanded. During the

March 2011 parliamentary elections, over 140,000 e-votes were cast – 24% of all ballots.

As a small country, Estonia generally has few problems with policy coordination. Its existing cabinet setting with a weak state chancellery supporting the prime minister enables effective policy design and conflict solution in the cabinet but creates problems in its strategy promotion as well as administrative (inter-ministerial) coordination of policy implementation. Policy coordination has been attempted through the adoption of a range of framework documents within major policy areas. Separate ministers without portfolio were also appointed for key fields such as minority integration and regional policy. However, these individuals have often found it difficult to pull together different agencies into one team. In this sense, coordination across ministerial borders could be improved.

Policy
coordination
8

Over the last three years the government has taken steps to consolidate a number of agencies, such as a merger of several law enforcement and security agencies into a single police and border guard board. This new organization would encompass the national police, secret service and border patrol as well as immigration/naturalization issues.

Estonia has paid considerable attention to fighting corruption, via both the national audit office and a special working group within the ministry of justice. The former has carried out numerous hard-hitting financial audits of both central and local government authorities and programs, while the latter has focused on implementing a national anti-corruption strategy as well as raising public awareness.

Anti-corruption
policy
9

In April 2008, the cabinet approved a new five-year anti-corruption policy program. The plan called for additional efforts to fight corruption in the private sector, which covered entrepreneurs' occasional readiness to pay bribes to win state contracts (as opposed to the solicitation of such bribes by civil servants). Corruption also remained a problem in the health sector with individuals sometimes still offering medical staff payments to facilitate treatment. In a performance report issued in 2010, the ministry of justice admitted that some of its awareness and other programs could not as yet be implemented because of austerity measures.

The question of party finance remained a major public issue in 2009 – 2010. In advance of the 2011 parliamentary elections, many observers called on parliament to pass a measure that would create an independent authority to monitor parties' campaign spending and overall financial dealings. Many politicians suggested, however, that a special parliamentary committee be created for this task. Anti-corruption advocates dismissed this idea because it would still leave the parties to monitor one another, and it was highly unlikely that any single committee member would ever dare speak out against his/her party. In late November, parliament nonetheless approved the creation of a new party financing oversight committee,

which would examine all campaign expense reports from parties, electoral coalitions and individual candidates. The committee would be made up of party delegates as well as representatives from the chancellor of justice's office, the national audit office and the national electoral committee. It would begin work after the March 2011 elections.

16 | Consensus-Building

Estonia has had a very strong consensus on the strategic aims of a market economy and democracy that pre-dates re-independence in 1991. This has been reinforced by the fact that although Estonia has had a steady rotation of cabinets over the past 16 years, for two-thirds of that time the governments have had a center-right profile. The victory of the RP in the March 2011 election only reinforced this trend.

Consensus on goals
10

Estonia has no anti-democratic actors within the political class, neither the military nor any other outside groups. Such actors existed only among remnants of the pro-Soviet, anti-independence movement from 1990 – 1991, but were quickly sidelined following independence.

Anti-democratic actors
10

Since the public acrimony and riots that surrounded the Bronze Soldier crisis in April 2007, little has improved in terms of dealing with Estonia's main social cleavage: The gap between ethnic Estonians and Russian speakers. The spark for those disturbances came from a government decision to relocate away from downtown Tallinn a statue commemorating the Soviet liberation of Tallinn from the Nazis in 1944. A majority of the Russian-speaking community in Estonia viewed this relocation as a desecration of the memory of Soviet victory in World War Two, while most Estonians saw the statue as a symbol of the post-1944 Soviet occupation. The firm stance of the government on moving the statue meant that many minority integration programs (which had been very successful since 1999) were also compromised. When Prime Minister Ansip decided in May 2009 to drop the SDP from his governing coalition, one of the party's ministers was responsible for integration affairs. This position, however, was not renewed in the new cabinet. Instead, integration policy areas were divided between the education and culture ministries. No public flare-ups have since ensued, but this is primarily because the Russian minority community also lacks strong leaders who could act as mobilizers.

Cleavage / conflict management
7

In 2006, the government passed a Civic Initiative Development Plan 2007 – 2010, which mandated the appointment of special coordinators in each ministry to facilitate public consultation. The coordinators, in turn, were directed to meet regularly in order to exchange best practice. Yet a 2010 study carried out by the PRAXIS Center for Policy Studies showed that there remain areas where public consultation could be improved. In particular, the study noted that ministries do not disseminate enough information about the issues are on their agenda to involve civil

Civil society participation
9

society actors adequately. Often such groups are consulted only at the end of the policy formulation process. In comparison to a similar survey conducted in 2004, many civic leaders who were interviewed did acknowledge that they were now taken more seriously by policy-makers and were no longer treated simply as hobby associations. Still, the PRAXIS report maintained that ministries should make consultation more a part of their overall job culture in order to realize its true potential.

Another increasingly established mode of policy participation involved analyses and reports generated by think tanks like PRAXIS. Estonian ministries were increasingly commissioning independent research from such organizations. Alongside PRAXIS, a public policy center was created in 2009 at the University of Tartu, and other groups like the Institute of Baltic Studies were employed.

The issue of historical and moral justice has operated in Estonia on two levels. In contrast to some other post-communist countries, Estonia never pursued an extensive policy of lustration or the criminal prosecution of communist-era officials. The names of around 650 former KGB employees have been made public (most recently in December 2009). Meanwhile, victims of the Soviet security forces have been given access to all secret files pertaining to themselves. However, no meaningful restrictions have been placed on the activities of former regime officials or agents.

Looking farther back into history, Estonia has also attempted to prosecute individuals it claims were directly linked to mass arrests and deportations from the 1940s. As a rule these defendants have been old men, however, in many cases they have been indicted for no less than “genocide” or “crimes against humanity.” Over the years, the Estonian security police and the Estonian prosecutor’s office have initiated 12 criminal cases, of which 11 ended in conviction.

On a symbolic level, in 2008 President Toomas Hendrik Ilves launched a new Estonian Institute of Historical Memory to deepen the study of human rights abuses and oppression under Soviet rule. The institute has organized various seminars and conferences, but its work has mostly been limited to archival research. Little public outreach has been undertaken.

The main challenge is to find a new historical understanding with Russia. However, this has so far proven elusive.

17 | International Cooperation

As a part of its membership in the European Union, Estonia has prepared extensive programs for allocating and monitoring the use of hundreds of millions of euros in EU structural funds, particular during the current 2007 – 2013 financial period.

Reconciliation
8

Effective use of
support
10

While much of the aid has gone on infrastructure projects (such as roads and other communication systems), a large share has gone into human resource development, including higher education and research. In July 2009, a group of independent analysts released a study assessing the continued suitability of Estonia's EU financing plans amidst the economic crisis. The report found that on the whole Estonia's development programs were still valid; however, it recommended that extra aid be channeled into programs with more immediate effect, such as labor market assistance policies.

Thanks to Estonia's successful economic austerity measures, the country was able to retain credibility in the international markets and with international financial institutions. Estonia's sovereign ratings have been stable in the A and A- range. Cooperation with the World Bank and IMF has been good, especially since the country did not need to resort to any emergency financing. Credibility with the European Central Bank and the group of eurozone countries was evidenced by Estonia's adoption of the currency in January 2011.

Credibility
10

Since the collapse of the Soviet Union, the Baltic and Nordic areas have become a multi-dimensional arena for regional cooperation. For Estonia, the first level of cooperation in the 1990s was with its Baltic neighbors, Latvia and Lithuania. Since then, however, the country has shifted its emphasis more to the Nordic countries and the Nordic Council. Melding both Baltic and Nordic interests, Estonia has also actively supported the "Nordic Baltic Eight" framework encompassing Estonia, Latvia, Lithuania, Finland, Sweden, Denmark, Norway and Iceland. Cooperation through the Council of Baltic Sea States (which adds Russia, Poland and Germany to the mix) has also been fruitful, but less significant. One major milestone in 2010 was Estonia's acceptance into the OECD.

Regional
cooperation
9

The main regional partner that remains underengaged is Russia. In 2005, Estonia and Russia signed a long-awaited border agreement, settling years of controversy about how to deal with a border shift Stalin carried out in 1945, moving some 2,000 sq. km of territory to the Russian Federation. A political dispute over how to interpret the treaty, however, erupted between the states during the summer, and Russia eventually withdrew from the agreement.

Strategic Outlook

Estonia will go down in history (together with Latvia) as having suffered one of the greatest one-year economic contractions in Europe. At the same time, it succeeded (contrary to its southern neighbor) in enacting tough austerity measures and avoiding a financial meltdown. This allowed the country to enter the eurozone in 2011 and lay the foundations for an even deeper level of economic integration with Europe.

The strategic outlook for Estonia is therefore one in which the scope of maneuver for its political and economic governance would be much narrower given its further incorporation into European frameworks. One danger of this integration is eventual pressure to abandon some of its prized taxation policies, including a flat-rate income tax and a zero-tax on reinvested corporate profits. At the same time, because Estonia's basic financial health was good, it would not be as vulnerable as some other eurozone countries.

Estonia will also face an important restructuring of its labor market in the years ahead, given a substantial narrowing of the construction and other market sectors that had previously driven its economic growth. The country had invested a considerable amount of EU and other funds into innovation and small business support. But there was still a need to find more long-term and higher value-added economic sectors in which to prosper.

The political system will in all likelihood remain stable. With the 2011 reduction in the number of parliamentary parties to just four, government coalition making was clear-cut and durable. Politicians were also increasingly experienced. (Andrus Ansip's new cabinet in 2011 included two ex-prime ministers and just two members without any prior ministerial experience.) Needless to say, the country also risked tipping in the opposite direction, in which politicians could increasingly become impervious to real competition and scrutiny. Moreover, the persistent tendency to ostracize the CP and its leader Edgar Savisaar (despite its large electoral following) meant that there continued to be a major dividing line in Estonian party politics. Because this line overlapped with Estonia's ethnic cleavage (a large majority of Estonia's Russian-speakers supported the CP), this divide was doubly reinforced.

Estonia is approaching an important threshold in its transformation since 1991. It has achieved its cherished goal of entering Europe's major economic and political organizations. It has been hit by, but endured a major economic crisis. It has achieved a notable degree of political stability. Its population was relatively satisfied with the direction of the country. Yet it also needed to build on those experiences and achievements, especially in finding new sources of economic growth and expanded social welfare. A new generation of younger Estonians with little or no memory of the Soviet era is beginning to take hold. These people, will have higher expectations than their parents. The country's leaders will have to begin to respond to this new perspective on Estonia's future.

