

BTI 2010 | Estonia Country Report

Status Index	1-10	9.34	# 4 of 128	
Democracy	1-10	9.60	# 4 of 128	➔
Market Economy	1-10	9.07	# 5 of 128	➔
Management Index	1-10	7.33	# 3 of 128	

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

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

The BTI is a joint project of the Bertelsmann Stiftung and the Center for Applied Policy Research (C•A•P) at Munich University.

More on the BTI at <http://www.bertelsmann-transformation-index.de/>

Please cite as follows: Bertelsmann Stiftung, *BTI 2010 – Estonia Country Report*. Gütersloh: Bertelsmann Stiftung, 2009.

Key Indicators

Population	mn.	1.3	HDI	0.88	GDP p.c.	\$	20361
Pop. growth	% p.a.	-0.1	HDI rank of 182	40	Gini Index		36.0
Life expectancy	years	73	UN Education Index	0.96	Poverty ²	%	<2
Urban population	%	69.4	Gender equality ¹	0.66	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

Executive Summary

Three events or trends best characterize Estonia's democratic and economic development from 2007 to 2009: the controversy over the statue of the Bronze Soldier, continued problems with the financing of political parties and the impact of the global economic crisis. The controversy over the Bronze Soldier ignited when the Estonian government removed a Soviet-built World War II memorial from a park in downtown Tallinn, which prompted two days of unprecedented rioting by Russian-speaking youths in the city center. The issue had been brewing for almost a year but evolved into a crisis situation when Prime Minister Andrus Ansip took a personal lead in forcing the statue's relocation, despite objections from Russian community leaders and even some Estonians. Many Estonians saw the monument as a Soviet relic, which memorialized the Soviet occupation in 1944 rather than the country's liberation from fascism. Russians, on the other hand, saw the statue as part of their historical identity and took action to defend it. Ultimately, the Bronze Soldier incident showed that the ethnic cleavage between Estonians and Russians continues to exist despite considerable efforts over the last 6 or 7 years at minority integration.

The continued lack of transparency in the realm of the financing of political parties casts a major shadow over Estonia's process of democratic transformation. Although Estonia has a generous system of state financing for parties and in 2003 took the bold move of outlawing corporate contributions to parties, new controversies about how parties have been raising money continued to surface. The Center Party has been the target of the most suspicions. It maintains close dealings with a private media concern and was also accused in 2008 of charging inflated prices for advertising space in its party newspapers, which was therefore seen as a kickback. In 2007-2008, Estonia's legal chancellor tried to institute a tighter oversight mechanism for party finance by appealing to the Estonian Supreme Court. The court rejected the appeal and left the system intact.

By the end of 2008, the world financial and economic crisis had engulfed Estonia. Although the existence of a stabilization fund that the country has been saving since the early 2000s cushioned the fiscal impact of the downturn, the government still needed to pass several rounds of budget cuts. Meanwhile, economic growth turned sharply negative, unemployment rose and exports slowed. The crisis constituted the most serious challenge yet to Estonia's hitherto relatively noteworthy post-communist transformation.

History and Characteristics of Transformation

Political and economic transformation in Estonia began with advent of Mikhail Gorbachev's perestroika and glasnost policies within the Soviet Union. Although the Soviet republic's Communist Party initially resisted reform, civic and intellectual leaders used the opening to mobilize the population around a range of grievances, including industrial pollution, the constant influx of Russian workers, Russification and economic degradation. These issues soon coalesced into an even bigger movement for Estonian independence. In March 1990, the republic declared its formal intention to restore independence. Actual release from the Soviet Union came in August 1991.

Estonia's democratic transformation has been characterized by a unique political doctrine known as legal restoration. According to this principle, Estonian independence in 1991 did not mark the beginning of a new era of statehood, but rather signified the restoration of the pre-1940 Estonian Republic. This approach greatly contributed to legitimizing democracy and created the momentum for the quick adoption of a new constitution in 1992. At the same time, the new Estonian government, applying the principles of legal restorationism, excluded from automatic citizenship all post-1940 settlers (mostly Russophones) by classifying them as illegal immigrants from a foreign occupation. These settlers became eligible for naturalized citizenship only if they passed an Estonian language and civics test.

The doctrine of legal restorationism also affected Estonia's economic transformation by highlighting the country's market economy from the interwar period. Restorationism led to extensive property restitution (the return of Soviet-nationalized property), which became a very long (and still ongoing) bureaucratic process. In terms of economic activity, Estonia largely abandoned Soviet-era heavy industry (with the exception of oil shale), and promoted export-oriented service industries, biotechnology and IT industries. 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, two related key assets underpinned Estonia's transition management: a strong sense of determination and political courage and readiness for innovative approaches. The national consensus on transition partly excluded the Russian minority and was partly a reaction to Russian obstruction (locally and internationally). Despite

the formalism of restorationism, most policies were remarkably innovative and future-oriented. In comparison to other post-communist countries, Estonia quickly confronted emerging developments such as democratic apathy, EU skepticism, de-industrialization, globalization and an aging population. Conversely, Estonia's reactions to political centralism, regional policy and ethno-politics remained rather conservative.

Transformation Status

I. Democracy

1 | Stateness

The Estonian state has a clear monopoly on the use of force in the country. No extra legal forces or threats to the country's territorial integrity exist. In the northeast of the country (mainly in Ida-Virumaa County), the presence of a majority of ethnic Russians has created an ethnic cleavage. In the early 1990s, Estonia feared that this region might become secessionist in favor of Russia. This threat quickly dissipated, however, as Estonian statehood became more stable and the economy began to improve.

Monopoly on the use of force

Estonia defines itself as an Estonian nation-state with an integration policy for historical and new minority groups. The country's Russian-speaking minority of roughly 30% have at times found this national identity problematic and have expressed the desire for more recognition as a constituent ethnic group in the state by, for example, an official policy of bilingualism. Moreover, the ethnic cleavage has overlapped considerably with citizenship status, because shortly after re-independence in 1991 Estonia adopted a conservative citizenship policy. This policy 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 and that on the basis of 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 citizenship. In numerical terms this amounted to around 400,000 out of a total national population at the time of around 1.4 million.

State identity

Over the succeeding years, some of these people re-settled in Russia, while others remained in Estonia but took Russian Federation citizenship. Others completed the naturalization requirements and successfully acquired Estonian citizenship. Some ethnic Russians, however, did nothing and became stateless persons with permanent residency in Estonia. By January 2009, roughly 84% of Estonia's residents were citizens of the country, 7.2% were Russian Federation citizens and 8.2% were

stateless. In this respect, the citizenship legacies of Estonia's legal restorationist doctrine were slowly being overcome.

The Estonian state is wholly secular. Organized religion exerts no influence on the state. While two main religious confessions, Lutheranism and Russian Orthodoxy, exist in the country, the percentage of people professing a religious affiliation (according to the 2006 European Social Survey) was just 28%. This figure has changed little during the entire transformation period.

No interference of religious dogmas

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 to be able to specialize its civil service in all fields, but this has not hindered its basic governance functions.

Basic administration

2 | Political Participation

Estonia most recently held free and fair national elections in March 2007. Since 1991, the country has held five parliamentary and five municipal elections. No major voting problems have emerged. Estonia's restrictive citizenship policy limited by nearly 40% the number of eligible voters during the early 1990s. By 2007, however, increased naturalization caused this figure to shrink to 17%. Moreover, Estonia allows non-citizens to vote in local elections, meaning that in these polls the full voting age population can participate.

Free and fair elections

Estonia is a parliamentary democracy. The prime minister is nominated by the president but is appointed into office by and remains accountable to a majority of the parliament. No outside veto players threaten 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

Estonia's constitution guarantees the freedoms of assembly and association. Supplementary legislation has bolstered these rights. 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 associations. All of these procedures are consistent with basic democratic ideals.

Association / assembly rights

Freedom of expression is unrestricted in Estonia, as provided by the constitution and additional legislation. In 2008, the organization Reporters Sans Frontières ranked Estonia fourth in the world for press freedom (tied with Finland and Ireland). The media landscape is relatively diversified with four national TV channels (two public, two private), four national Estonian-language daily newspapers, two Russian-language dailies, two Estonian-language weeklies and two

Freedom of expression

major Russian-language weeklies. Many of the media outlets are 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).

In 2007, Estonia's state television and radio were reorganized into a single unit henceforth known as Estonian Public Broadcasting (EPB). The move was seen as a streamlining measure, allowing the two media to pool their news gathering operations, combine Internet outlets and mix broadcast staff. In 2008, construction began on a new EPB headquarters to replace the Soviet-era studios and other facilities. In August 2008, the EPB launched a second nationwide digital television channel dedicated mostly to children's programming.

All of Estonia's major media are apolitical, although some observers have alleged certain political sympathies. Among the more controversial associations has been the link between the Center Party and Kalev Media, a new concern created in 2007 by Oliver Kruuda, the owner of a number of food industries. Kruuda is a notable financial contributor to the Center Party. His Kalev Media secured a contract to produce municipal affairs programming for the Tallinn city government, which is controlled by the Center Party. Little evidence, however, indicates that Kalev Media is attempting to push a political agenda.

3 | Rule of Law

The Estonian constitutional order is founded on a classical parliamentary system of checks and balances, whereby the prime minister depends on a parliamentary majority to stay in office, while 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 performs an additional oversight function by having the right to challenge the constitutionality of any legal act at the national or local level. If the relevant authority whose act has been challenged disagrees with the legal chancellor, the legal chancellor can appeal to the Constitutional Review Chamber. In addition, the legal chancellor performs the additional function of 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 the new constitution was adopted in 1992.

Separation of
powers

Estonia's judiciary has three tiers. Four county-level courts first hear all criminal and civil affairs. In addition, two administrative courts operate at the first level to hear cases involving administrative law. At the circuit level, three appeals courts exist to hear cases in cassation, while at the highest level the Supreme Court adjudicates all final appeals. The Supreme Court includes among its four subdivisions the Constitutional Review Chamber, which hears special appeals directly from either 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 is deadlocked on a case, it can refer the matter to the full Supreme Court.

Independent
judiciary

In terms of judicial independence, the issue of financing for the judiciary has been a controversial topic for many years. Whereas the Supreme Court, as a constitutional institution, has always maintained a largely independent budget, the Ministry of Justice sets the budget for the lower courts. Many observers argued that this arrangement is a potential source of conflict between the executive and judicial branches. In 2008, the minister of justice formed a working group to redraft the Courts Act in order to find a better financing scheme, although the question of whether or not the minister would go along with an entirely separate budgetary arrangement remains open.

Estonia's judicial impartiality also came under the spotlight in 2006 and 2007 when a county judge, Ardi Šuvalov, was arrested and later convicted of taking a bribe in order to dismiss a case against a businessman. Criminal trials against judges have been rare in Estonia, although the Supreme Court operates a judicial discipline commission, which in 2008 punished three judges for different procedural violations.

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 3% of respondents in a 2007 survey commissioned by the Ministry of Justice reported having paid a bribe over the last year. At the same time, two-thirds of Estonians believed that corruption continues to be a problem in the country, in particular in terms of paying bribes to avoid fines or other punishment.

Prosecution of
office abuse

The prosecution of high-level officials for corruption received prominent attention in 2007 and 2008 when the trial of former environment minister and leader of the People's Union party 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. In the scheme, the head of the Land Board had allowed a number of real estate developers to exchange various rural land holdings for prime urban real estate previously owned by the state. The trades drew scrutiny when it became apparent that the value of the urban tracts had been significantly undervalued in relation to the rural plots, thereby

giving a windfall to the developers. Reiljan's failure to keep an eye on this activity eventually led to further accusations by Estonia's Security Policy Board that Reiljan had actually 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. The company's chairman, Toomas Annus, became an additional defendant in the affair. In March 2008, Reiljan's immunity as a member of parliament was removed, and in late 2008 the state prosecutor in the case called for Tuiksoo's also to be revoked.

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. In addition to these provisions, however, the European Union has demanded that Estonia adopt legislation on gender equality and general non-discrimination. In 2004, parliament passed the Gender Equality Act, which created a special commissioner for gender equality. Thereafter, the Riigikogu debated an Equal Treatment Act aimed at formalizing anti-discrimination procedures across all social domains (pursuant to two important EU directives in this area). This measure ran into trouble, however, when some parliamentarians questioned provisions ensuring equality for homosexuals. Twice the bill failed to pass, until in December 2008 the act was passed and promulgated by the president. The new law expanded the purview of the commissioner for gender equality to include all forms of discrimination – a provision criticized by some as diluting the issue of gender equality. The new commissioner retained his or her powers to investigate suspected cases of discrimination and to facilitate their resolution in the courts when necessary.

Civil rights

4 | Stability of Democratic Institutions

Estonia's democratic institutions have been performing effectively, as evidenced by the country's accession to the European Union in 2004. No major difficulties have occurred since then. Institutional conflicts have been minimized or dealt with through the general system of checks and balances, such as presidential vetoes or constitutional cases brought by the legal chancellor.

Performance of
democratic
institutions

Compared to other post-communist countries in Europe, Estonia has achieved an average level of governmental stability. Since 1992, it has had 11 cabinets, each one lasting an average of 1.5 years. No government has survived a complete parliamentary term. Still, cabinet duration has increased over the last few years. The current prime minister, Andrus Ansip, has remained in office for nearly four years, albeit with two separate cabinets.

No challenges to the legitimacy of Estonia's democratic institutions have arisen since the adoption of the 1992 constitution. All relevant political and social players accept the democratic order.

Commitment to democratic institutions

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 decreased and political cleavages have become more distinct. Following the 2007 elections, the number of effective parliamentary parties reached a low of 4.4 (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 just 4.4.

Party system

Ideologically, the system has coalesced around three poles: a national-conservative one (led by the Pro Patria & Res Publica Union, PRRPU), a market liberal one (led by the Reform Party, RP), and a center-left one (anchored by the Center Party, CP, but also occupied by the agrarian People's Union, PU). The Social Democratic Party (SDP, formerly the Moderates) has also long professed to be a center-left party but has refused to cooperate with the Center Party, because of the domineering nature of the CP's long-time leader, Edgar Savisaar. This has forced the SDP to participate in government coalitions with the PRRPU and the RP, which has muddled its image among voters. Meanwhile, the CP has often been seen as a pariah party because of its rough style and occasional calls for greater cooperation with Russia.

Despite having a large Russian-speaking population, Estonia has not had any Russian parties represented in the parliament since 2003. Rather, ethnic Russians have increasingly supported the Center Party, which has co-opted many prominent Russian-speaking leaders into its ranks. In 2007, a new Green Party gained 6 seats in the parliament; however, its long-term viability remains to be seen.

The key to the party system has been the Reform Party, which has deftly succeeded in playing the partner at different times to both the PRRPU and the CP. As a result, it has been a member of the government continuously since 1999, and for five of those ten years it has even led the cabinet. Following the Bronze Soldier crisis, the RP's popularity skyrocketed to over 40% – an unprecedented score for any Estonian political party in modern times. By the end of 2008, this share had fallen down to 29%, while the Center Party climbed above 30%. The remaining parties hovered between 8 and 12%.

The participation of interest groups in Estonian policy-making and societal affairs has evolved together with the general development of Estonia's market economy and the country's accession to the European Union. One of the earliest examples of

Interest groups

structured participation involved the holding of regular tripartite negotiations between the government, employers' associations and trade unions over national wage agreements and other aspects of social policy. Over the last few years, these talks have been held directly between the employers and trade unions with the government playing only a supporting role. As part of EU accession, the government also formalized procedures for consulting with interest groups over various relevant policy issues.

In a 2007 survey commissioned by the Department of Political Science at the University of Tartu, 64% of respondents said they were either "generally satisfied" or "very satisfied" with the way democracy works in Estonia. Only 32% felt that it would be better if a single strong leader ruled the country without parliament or parties. At the same time, this high level of "regime support" did not translate automatically into satisfaction with "regime performance." When asked whether they believe politicians care about people like them, only 32% responded affirmatively.

Consent to
democratic norms

Estonia's voluntary organizations fall mainly into two groups. As of October 2008, roughly half of the country's 27,625 registered citizen associations were apartment cooperatives. These were created during the years of housing privatization, and although they mostly deal with simple management issues, they have served as important grassroots loci 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 associations. In 2007, the USAID's NGO Sustainability Index gave Estonia a ranking of 2.1, which was the highest score for any post-communist country. Still, surveys have shown that upwards of 75% of Estonians do not participate in any voluntary or charitable organizations, and civic organizations employ only around 4-5% of the labor force.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

In its 2007-2008 Human Development Report, the United Nations ranked Estonia 42nd in the world with a Human Development Index of 0.871, just above the other two Baltic states but behind the post-communist countries of Central Europe. The report also noted a Gini coefficient of 35.8, which is roughly where the country has been since 2000. According to the Estonian Statistical Office, the percentage of people at risk of poverty has averaged around 18% since 2000, but this figure

Socioeconomic
barriers

started an upward trend in 2006. In particular, Russians and other minorities showed higher rates of poverty, as well as residents in northeast Ida-Viru County, where about 40% of Russians live. Among other at-risk regions was the southeastern Põlva County, where poverty was three times higher than in the capital, Tallinn.

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	11989.3	13790	16449.1	20958.7
Growth of GDP	%	7.5	9.2	10.4	6.3
Inflation (CPI)	%	3.0	4.1	4.4	6.6
Unemployment	%	9.6	7.9	5.9	4.7
Foreign direct investment	% of GDP	8.1	21.3	10.9	12.8
Export growth	%	14.2	20.9	11.6	0.0
Import growth	%	15.5	17.5	20.4	4.2
Current account balance	\$ mn.	-1412.7	-1381.6	-2758.7	-3771.8
Public debt	\$ mn.	-	-	-	-
External debt	\$ mn.	-	-	-	-
Total debt service	% of GNI	-	-	-	-
Cash surplus or deficit	% of GDP	2.1	2.0	2.8	3.2
Tax Revenue	% of GDP	16.0	16.2	16.5	17.2
Government consumption	% of GDP	17.7	17.3	16.5	17.2
Public expnd. on edu.	% of GDP	5.0	4.9	-	-
Public expnd. on health	% of GDP	4.0	3.8	3.8	-
R&D expenditure	% of GDP	0.9	0.9	1.1	1.1
Military expenditure	% of GDP	1.7	1.9	1.9	2.2

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

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. Estonia has no price controls, the Estonian kroon is fully convertible, and the number of days needed to open a business is seven. All market participants enjoy equal opportunities. Profits may be freely used and transferred.

Market-based competition

Estonia established a Competition Board in 1993 with the main function of enforcing the country's Competition Act, adopted that same year. This act (as later amended and together with a number of supplementary government decrees) defines and establishes sanctions for all "agreements, concerted practices and decisions" among firms that restrict free market competition. In 2008, the government reorganized the Competition Board into the Competition Authority and merged it with a number of other oversight institutions such as the Energy Market Inspectorate and the Railways Inspectorate. One of its recent high-profile cases was a decision in 2008 to stand against the slow but steady incorporation of Estonian pharmacies into two large chains. The Competition Authority argued that this trend posed a threat to price competition in the market for drugs and other remedies. The authority has also played an active role in monitoring utility prices (e.g., water, natural gas, heating and gasoline).

Anti-monopoly policy

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 European Union's general foreign trade regulations following accession in 2004, but it has continued to maintain an open economy. This liberalism became a kind of vulnerability with the global financial crisis of 2008. Despite the hardships caused by the crisis, no political actors in Estonia have called for protectionism.

Liberalization of foreign trade

The years 2007 and 2008 marked a symbolic end to the Estonian banking system when both major retail banks, Ühispank and Hansapank, changed their names to conform directly with their Swedish owners, SEB and Swedbank, respectively. The brand shift epitomized the degree to which the country's banking system has become internationalized. At the same time, because the future of the Estonian banking sector depends heavily on the business decisions of Swedish bankers, the country is exposed to possible powerlessness in times of financial crisis.

Banking system

8 | Currency and Price Stability

Inflation remained a major policy concern in Estonia through 2008, when the country's consumer price index soared to 10.4%. Part of this steep rise was due to skyrocketing oil and other fuel prices. Strong consumer demand and rising wages, however, drove some of it. Both the government and the independent Bank of

Anti-inflation / forex policy

Estonia refrained from enacting any direct anti-inflation measures, arguing that to some degree inflation was inevitable in a rapidly expanding economy. Still, the particularly high level of inflation meant that Estonia's adoption of the euro would be delayed until at least 2011.

Estonia has maintained an extremely conservative fiscal and debt policy since independence, operating many years with a surplus national budget and storing that cash away in a stabilization reserve. By 2008, this reserve amounted to some 7 billion kroons (or nearly €450 million), which the government announced could be used to offset some of the drastic shortfall in government revenue expected in 2009. Already in the second half of 2008, Estonia passed an austerity budget to cut back spending, and after adopting an initial budget for 2009, the government announced a further round of budget cuts of roughly 8%, because revenues continued to decline more substantially than expected. In this respect, Estonia faced a period of macroinstability, during which the government sought to cope with the fallout from its high-growth economic strategy over the last 10 years. While this strategy boosted overall living standards, it also eventually precipitated a real estate crisis and a collapse of economic activity once cheap borrowing from abroad came to an end.

Macrostability

9 | Private Property

Estonia laid the groundwork for a stable and equitable system of property rights during the 1990s when, first, it enacted an extensive program of property restitution (or the return of Soviet-era nationalized property) and later passed a slate of laws for the protection of new property. The courts (including the Constitutional Review Chamber) have adjudicated numerous cases concerning property rights, and these rulings have all been respected.

Property rights

Article 31 of the Estonian constitution states explicitly that Estonian citizens shall have the right "to engage in enterprise and to form commercial undertakings and unions." In terms of economic policy, the state views private companies as the primary engines of economic production. According to the Estonian Statistical Office, the general government share in gross value added has been only around 12.5%. The state moved to privatize most of the country's major government assets 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 | Welfare Regime

After years of pursuing a tight fiscal policy, Estonia took a number of steps in 2003 and 2004 to expand its social welfare regime. Between 2005 and 2009 the average old-age pension nearly doubled to 4090 kroons (€61) per month, the minimum level of tax exempt income rose by 35% and in 2004 an extensive parental leave policy was enacted, allowing mothers and fathers to take up to 15 months of fully paid leave to spend time with their newborn children. In addition, beginning around 2000 the country restructured its pension system around the three pillars of a minimum state pension, a funded pension (based on joint state and individual contributions) and private pension schemes. All of these welfare measures came under close scrutiny in early 2009 when Estonia faced a series of major budget cuts. A reduction of any of these benefits would likely cause widespread public displeasure.

Social safety nets

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 consequence of the market. While Estonia has both a Gender Equality Department (within the Ministry of Social Affairs) and a gender equality commissioner, the government has taken few active measures to ameliorate these differences.

Equal opportunity

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 has not focused much attention on developing measures to expand minority opportunity.

11 | Economic Performance

From 2000 to 2007, Estonia's real GDP growth averaged over 8%. This prompted the country's GDP per capita to climb to \$15,860. In 2008, as the economy began to slow down, many analysts talked of a soft-landing with growth decelerating to perhaps 3-4%. By the end of the year, however, quarterly GDP growth was negative and Estonia was headed for a serious downturn. Part of the structural challenge for the economy involved increasing exports to alleviate a current account deficit that reached 18.1% of GDP in 2007. Early in 2009, Estonia's trade balance started to improve, but this was due primarily to a decrease in imports as consumption declined. Inflation also posed a major problem, as sustained economic growth put heavy upward pressure on wages and prices. Thankfully, the country's public debt was just 3.8% of GDP and the government had amassed a stabilization fund of

Output strength

roughly €450 million before the start of the crisis to help alleviate some of the expected hardship.

12 | Sustainability

While Estonia had a notable history of environmental protection even during the Soviet era, it has struggled to deal with two major legacies from that period. The first is cleaning up topsoil and water pollution caused by several Soviet air bases and their dumping of kerosene into the ground. The second involves reducing air pollution from two large electricity plants near the northeastern city of Narva, which operate on oil shale. While the plants have been fitted with better filters and other mechanisms, a long-term future of electricity production based on oil shale is a cause of concern. In particular, the European Union has demanded that Estonia comply with strict carbon dioxide emissions quotas by 2013 and close the electricity plants by 2015. As an alternative, Estonia has been looking into participating in an international project to revamp the Ignalina nuclear power plant in Lithuania.

Environmental
policy

The 2007-2008 trial of former environment minister Villu Reiljan for possible bribe-taking from real estate developers in exchange for state lands cast a shadow over the integrity of the top leadership in the ministry. At lower administrative levels, however, environmental protection agencies appeared sound.

Although state spending on education in Estonia grew annually over 10% from 2001 to 2006, the share of this spending as part of the country's GDP actually fell from 5.3% to 4.6%. Meanwhile, spending on R&D grew to 1.14% of GDP in 2007 and the share of private sector spending in this area rose from a third in 2003 to almost half in 2007. The number of scientists and engineers per thousand employed persons has also risen consistently and was at roughly ten in 2007. However, in all of these figures Estonia still fell below the EU average.

Education policy /
R&D

Transformation Management

I. Level of Difficulty

Estonia's structural constraints are low. Its population is well educated (with a high UNDP Education Index), economic development has been good, and social problems are manageable. The growing financial crisis had already eased its labor shortage problem, which was present in 2005-2006. Estonia will face a major contraction of wages and a need to retrench rising standards of living. With sound fiscal management, the country can weather the crisis.

Structural
constraints

By early 2009, the number of officially registered HIV-infected persons in Estonia was approaching 7000, while estimates put the actual number of carriers at 12,000. Given Estonia's small population, this was a sizeable number. More than half of new infections continue to be in northeastern Ida-Viru County, meaning that the disease has spread disproportionately among Estonia's Russian-speaking population. Overall, however, the yearly number of new infections has decreased.

Estonia has a notable tradition of civic activism as demonstrated by both the population's broad participation in the independence movement and its strong cultural tradition of choral singing and national song festivals. In recent years, other forms of civic associations have also grown, thanks to rising standards of living and the implementation of specific programs such as the Estonian Civil Society Development Concept and the creation of a special Civil Society Foundation to support the concept financially. Levels of interpersonal trust have risen and in 2006 (as measured by the European Social Survey) were at or above the European average. Trust in political institutions was also around the EU average, though in absolute terms low with only 32% of respondents trusting the national parliament and 16% trusting politicians.

Civil society
traditions

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) continue to feel alienated in Estonian society. Moreover, the conflict showed how the two communities viewed history as well as the issue of minority integration in diametrically different ways. In a poll conducted two months after the crisis, 79% of Estonians believed the decision to relocate the monument was correct, while

Conflict intensity

76% of non-Estonians were of the opposite opinion. Concerning the actual rioting, 74% of Estonians believed the violence was part of a desire on the part of Russia to destabilize Estonia, while only 13% of non-Estonians agreed with that view. For their part, non-Estonians blamed the Estonian authorities for not seeking compromise or making available enough information about what was being done. They were also critical toward the actions of the police.

In terms of general ethnic relations, roughly half of all Estonians and non-Estonians believed these had worsened as a result of the incident. Moreover, 58% of non-Estonians believed that the crisis was not entirely over, although since April 2007 no major tensions or confrontations have re-surfaced.

II. Management Performance

14 | Steering Capability

Long-term policy planning has depended in Estonia on the existence of stable government coalitions. These have generally been from the center-right, including the coalition currently in power since April 2007 between the Reform Party, the Pro Patria & Res Publica Union and the Social Democratic Party under Prime Minister Andrus Ansip. While all of Estonia's governments have been committed to constitutional democracy, coalitions like Ansip's first cabinet (2005-2007), which consisted of the leftist Center Party and the agrarian People's Union, were more stopgap administrations because previous cabinets had broken down. Such coalitions were more prone to short-term interests such as pre-electoral posturing. If the current coalition continues to hold amidst the financial crisis and until the next elections in 2011, it will be a strong indicator of stability.

Prioritization

Estonia's process of accession to the European Union showed a willingness and capacity to consistently implement wide-ranging reform programs across a number of different administrations. Since accession, however, questions have been raised about the politicians' ability to formulate new long-term goals or constructive policy aims. Andrus Ansip's current government came into office in 2007 with reform plans aimed mostly at reducing taxes and expanding social welfare benefits. During its first six months, it achieved these aims by passing relevant legislation in parliament. The government also took major steps toward reorganizing the state accounting system from a cash to an accrual method. Plans to overhaul the civil service and public administration stumbled, however, in January 2008, when the minister appointed to oversee the reform was withdrawn by his own political party

Implementation

because he failed to draw up a reasonable reform strategy after eight months of work. This indicated a more fundamental inability to manage complex implementation mechanisms.

Estonia represented an interesting case of policy learning during 2008-2009, as the ruling coalition struggled over how to square its original government program promising significant tax cuts and increases in social spending with the onslaught of the global economic crisis. This situation created the most difficulty for Prime Minister Ansip's Reform Party, because it had to forego its long-time commitment to continual gradual decreases in Estonia's flat-rate income tax as its main economic policy plank. Since 2003, the Reform Party had spearheaded a lowering of the rate from 26% to 21% in 2008 with a plan to reach 18% by 2012. In 2008, the party agreed to suspend this demand and to look into other ways to increase government revenues.

Policy learning

During 2008, Prime Minister Ansip came in for criticism for continually painting a rosy picture of the Estonian economy, even though signs of a crisis began surfacing already in the spring. By early 2009, however, he had come around to a policy of extensive budget cuts, driven in part by Finance Minister Ivari Padar.

15 | Resource Efficiency

Estonia's small population puts a premium on efficiently using its human resources, but it also heightens the potential for conflicts of interest or decisions motivated by personal relations. Ministers have tried at different times to replace the director-general (or top civil servant) in their ministry when they have not seen eye-to-eye politically. Political appointees in civil service, however, are rare. Another bone of contention has been the practice of cabinet ministers appointing MPs to the executive boards of various state-owned enterprises. While the ministers have argued that the MPs' role is to serve as an overseer of state interests in these companies, in practice the appointments have often become a political perk, where MPs earn generous salaries but do very little. Before his term of office ended in 2008, Legal Chancellor Allar Jõks challenged this procedure repeatedly, calling it a violation of the constitutional principle of separation of powers. The executive, he argued, could not simply appoint members of the legislative branch. Parliament refused to change the rules. In 2007, the new governing coalition between the Reform Party, the Pro Patria and Res Publica Union and the Social Democratic Party also argued over the issue with the latter two parties insisting that the practice be stopped. The Reform Party rebuffed the demand, and in the end the parties decided to allow each side to do what it wanted.

Efficient use of assets

In terms of financial efficiency, maintaining a balanced budget has long been a cornerstone of Estonian fiscal policy, allowing the country to have a miniscule state

debt of just 3.8% of GDP. Administrative costs in Estonia's local governments have also averaged around 12%. In a 2008 report, the National Audit Office noted that government budgetary reports often list only the general goals ministries are attempting to achieve with their spending, while no account is ever given from a post-hoc point of view, meaning how much money was ultimately spent on a certain goal, whether it was spent efficiently and whether it was too much or too little.

One very positive aspect of resource efficiency has been Estonia's extensive development of e-government services. These include the electronic filing of tax returns, the growing use of digital signatures to submit official documents and the possibility of applying for social welfare benefits online. In 2007, Estonia became the first country in the world to allow Internet voting in a national election. Although only some 3% of votes were cast in this manner, the system was used again for the 2009 European elections. Observers speculated that voting might even be made possible via mobile phone by 2011. Authorities have been so keen to promote e-services that in 2008 the National Audit Office spearheaded the adoption of a "Charter of E-government" listing the e-rights of all Estonians.

Policy coordination has generally not been a problem at the national level, although central authorities have had difficulties monitoring local governments and their fiscal planning. During the early 2000s, many municipalities incurred sizeable amounts of debt while undertaking or co-financing different infrastructure projects. One small town, Püssi, eventually declared bankruptcy in 2005, while central government has needed to bail out eight other municipalities. In late 2008, the government introduced a bill to bring municipal fiscal planning procedures under tighter control.

Policy
coordination

Estonia has paid considerable attention to fighting corruption, through 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 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. 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, including 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 payments to facilitate medical treatment.

Anti-corruption
policy

Party finance was a major public issue in 2007-2008, as Legal Chancellor Allar Jõks formally contested the constitutionality of Estonia's existing party finance oversight procedures in the country's Supreme Court. Jõks argued that the current practice of vesting the power to review the identities of party donors and to monitor

other financial transactions merely in the hands of a parliamentary anti-corruption committee was insufficient to guarantee the constitutional principle of transparency in democratic politics. Jõks called on the Supreme Court to order the parliament to create a more independent oversight body with real sanctioning authority. While some of the justices agreed with the legal chancellor, a majority ultimately rejected his appeal, noting that other legal acts (such as accounting rules and tax directives) also regulated parties' financial dealings. When taken together, the court argued, these laws were sufficient to maintain democratic control. Still, the Council of Europe's GRECO association added to the criticism of Estonia's system of party finance. In the end, the government included the task of tightening party finance rules in its new anti-corruption program.

16 | Consensus-Building

Estonia has had a very strong consensus on the strategic aims of a market economy and democracy from even before re-independence in 1991. This has been reinforced by the fact that although Estonia has had a steady rotation of cabinets over the past sixteen years, two-thirds of that time the governments have had a center-right profile.

Consensus on goals

Estonia has no anti-democratic actors either within the political class, the military or among any 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
veto actors

Estonia's main social cleavage continues to be the ethnic one between Estonians and ethnic Russians. The Bronze Soldier crisis was a particularly unfortunate case of conflict mismanagement, where Estonian politicians backed themselves into a corner about the need to relocate this Soviet-era war memorial, even though its public importance was secondary. Prime Minister Ansip's particular involvement in getting a special law passed allowing the national government to move the statue (above the jurisdiction of the Tallinn city authorities) indicated a greater interest in pushing his point through rather than in talking with veterans groups and Russian community leaders. The adoption in April 2008 of a new five-year minority integration program helped to focus some positive attention on measures to improve the standing of the Russian-speaking population. Time is required, however, for Russian-speakers to re-build political trust toward the Estonian government.

Cleavage /
conflict
management

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. In its 2007-2011 coalition program, the government also devoted a separate section to civil society participation, promising

Civil society
participation

(among other things) to conceive of more opportunities for direct democracy at the local level. In June 2008, the government revamped its main public consultation portal by creating a system for users to register themselves and to post opinions and/or to vote on specific policy proposals. The portal also featured a regular calendar of upcoming policy discussions and a separate rubric for posting new policy ideas for discussion.

The issue of historical and moral justice has operated on two levels in Estonia. In contrast to some other post-communist countries, Estonia never pursued an extensive policy of lustration or conviction of communist-era officials. The names of some former KGB officials have been made public (most recently in January 2008), and individuals generally have access to all secret service files pertaining to themselves. The state has not placed any meaningful restrictions, however, on the activities of former regime officials or agents.

Reconciliation

Turning further back into history, however, the state has 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 and in many cases they have been indicted for no less than genocide. For example, in 2007-2008, the state put a well-known and highly decorated Soviet war veteran, Arnold Meri, on trial for alleged involvement in the deportation of 251 people from the island of Hiiumaa to Siberia in 1949. The case drew extra attention, since the defendant was a cousin of former President Lennart Meri (although the two were never close). The state also brought charges against two other KGB operatives from that Stalinist era in September 2008.

17 | International Cooperation

Following accession to the European Union in 2004, Estonia's main challenge in terms of effective use of support has been to wisely use its opportunities within the EU's structural and cohesion funds. In a 2008 report, the Estonian National Audit Office reported that over half of all local governments applied for and received some kind of funding. Though overall project implementation was good, many local governments had problems meeting co-funding requirements. The ENAO report added that this was likely to be a problem for the next round of EU funding during 2007-2013, especially since many local governments did not have sufficient administrative capacity to adequately judge their co-financing possibilities. This meant that local governments often ran the risk of taking on projects that they could not handle. In a rebuttal to the report, the minister of finance insisted that ultimately the local governments were responsible for ensuring that they could cover their commitments. He agreed, however, that closer attention needed to be paid to this aspect during the application review process.

Effective use of support

Estonia's sovereign ratings among international agencies changed little in 2007-2008, staying at the A-level. The country's lack of any major public debt and its possession of a stabilization fund were particularly cited as signs of its institutional credibility. At the same time, Estonia's outlook scores turned negative, with analysts warning that a sharp contraction of the economy could complicate the task of maintaining financial and fiscal stability.

Credibility

Estonia has been an active member in regional organizations such as the Council of Baltic Sea States, the Baltic Assembly and the Baltic Council of Ministers (which it headed in 2008). Estonia also led an initiative to integrate the Baltic states directly with the Nordic Council, creating the so-called Nordic Baltic Eight, which has met regularly.

Regional
cooperation

On a bilateral level, Estonia's relations with Russia deteriorated considerably during the Bronze Soldier crisis, when pro-Kremlin youth activists tried to surround the Estonian embassy in Moscow and disrupt its diplomatic activity as a protest action. The incident prompted the European Union to strongly rebuke Russia for not protecting the diplomatic outpost of an EU member. Russia, meanwhile, continued to accuse Estonia of attempting to demean the Soviet victory in World War II, while Estonia tried to put the incident in the past.

In 2007, Estonia also took a cautious stance toward the so-called Nordstream project to build a natural gas pipeline under the Baltic Sea from Russia to Germany, questioning several times whether the pipeline would be environmentally safe and whether it would have to pass through Estonian territorial waters.

Strategic Outlook

While Estonia went into the 2008-2009 global economic crisis with a certain number of advantages (low public debt, the existence of a stabilization fund, stable political leadership), the pace with which the economy turned into full reverse took many by surprise. Far from experiencing a soft landing, Estonia faced a hard bump and had to make a number of serious trade-offs to avoid a free-fall. By January 2009, political consensus had been reached on a range of budget cuts. The government's challenge was to adhere to those decisions and hope that no major company bankruptcy or financial failure would further aggravate the situation. Equally perilous were the prospects of large-scale unemployment and waves of property foreclosures, since thousands of Estonians had participated in a housing boom during the early 2000s, which caused real estate prices to inflate well beyond actual values. While Estonia experienced economic hardship in the early 1990s, this kind of downturn (e.g., falling middle-class salaries along with housing foreclosures) moved the country into uncharted territory – both economically and politically.

The economic crisis is likely to put other tense transformation issues, such as minority integration and administrative reform, on the back burner. Since the economic recession is universal, it is likely to affect ethnic Estonians and Russian-speakers equally. With Russia also suffering, the probability that Moscow will gain any added leverage over Estonia is minimal. Although Estonia continues to rely on Russia for 100% of its natural gas supplies, it also has other suppliers to draw on and its market as such is relatively minor.

As a small country, Estonia remains exposed to and dependent on the decisions of its larger neighbors and partners in the European Union. This concerns the banking industry in particular, but also foreign investment. At the same time, by virtue of its size Estonia has a greater degree of flexibility in its policy-making and labor markets. Hitherto touted as a Baltic tiger, Estonia will have to show those dynamic qualities again if it hopes to come out of the current slump successfully.