

BTI 2016 | Estonia Country Report

Status Index	1-10	9.49	# 2 of 129	
Political Transformation	1-10	9.70	# 2 of 129	➔
Economic Transformation	1-10	9.29	# 3 of 129	➔
Management Index	1-10	7.40	# 4 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	1.3	HDI	0.840	GDP p.c., PPP \$	26355.4
Pop. growth ¹	% p.a.	-0.3	HDI rank of 187	33	Gini Index	33.2
Life expectancy	years	76.4	UN Education Index	0.859	Poverty ³	% 0.0
Urban population	%	67.6	Gender inequality ²	0.154	Aid per capita	\$ -

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

Executive Summary

During the period under review, Estonia has generally recovered from the sharp economic recession of 2008 – 2009. It has been aided in this by innovative and highly efficient public and private sectors. The country has retained its attractiveness to foreign investors due to its openness, streamlined government, strong rule of law and business-friendly economic environment. Economic output has increased despite sluggish growth in the European Union and the government's financial position continues to be favorable, thanks to the lowest public debt levels in the European Union. Yet, the country also faces challenges linked to its small size and the openness of its economy. Economic growth is dependent on the inflow of foreign investments and external demand, both of which have been weak since the recession. Continued economic stagnation in the European Union and economic as well as political uncertainties related to Russia remain key risk factors.

Estonia has seen unprecedentedly high levels of political stability in the last decade. The incumbent center-right government was returned after the 2011 parliamentary elections, despite having implemented a radical austerity program during the recession. In March 2014, a new coalition of the Reform Party and the Social Democratic Party (SDE) (which replaced the Pro Patria and Res Publica Union or IRL as a coalition partner) came to power. Thirty-four-year-old Taavi Rõivas took over as the new prime minister after Andrus Ansip stepped down to become an EU Commissioner following nine years in office as the longest serving prime minister in the European Union. The party system has remained consolidated, with only four political parties (Reform Party, SDE, IRL and the Centre Party) represented in the parliament in early 2015. The 2013 local and 2014 European elections did not see any major changes in the support for the main parties. A number of new parties were set to contest the March 2015 national election, but only two of them stood a reasonable chance of entering parliament, and neither was likely to win more than 10% of the seats.

In recent years, there have been signs of civil society becoming more active in the political sphere. In 2012, several national strikes were organized and a People's Assembly was held to crowdsource proposals for democratic reforms, a selection of which were later submitted to parliament by the president after being reviewed by experts and discussed by a group of 300 randomly selected citizens. In 2014, opponents and supporters of a draft bill on civil partnerships for same-sex couples took to the streets and social media, as did disability rights organizations seeking to oppose the rushed introduction of a disability work reform. Nonetheless, the fact that civil society has become more vocal does not necessarily mean that it is particularly influential or effective, especially given the still low overall levels of civic participation. Often the focus of interest groups is on lobbying the president to veto bills, due to the perception that the government – and by extension the parliament – is not genuinely engaged in consultations. Indeed, progress involving the reforms put forth by the People's Assembly has been limited, and while some reforms have been passed, the original proposals were watered down.

Inter-ethnic relations between the ethnic Estonian majority and Russian-speaking minority have not significantly improved over the last decade. The ethnic cleavage is not fully politicized as the minority has mostly been represented by the cross-ethnic Centre Party. In recent years, it has strongly opposed education reforms that substantially increased the compulsory use of the Estonian language in Russian-language schools. Due to increasing tensions between Estonia and Russia in 2014 (primarily over the conflict in Ukraine), the party has been struggling to please both its ethnic Estonian and Russian-speaking constituencies as public attitudes regarding the situation in Ukraine and potential Russian threats are highly divided.

History and Characteristics of Transformation

The roots of the Estonian transition process lie in the reforms initiated by Mikhail Gorbachev in the mid-1980s. These led to increased openness and to some economic and political reforms. Already by 1988, Estonia enjoyed a fairly free public sphere with a number of non-communist political organizations campaigning openly and competing for public support. The main political divide ran between the republican Communist Party and various pro-independence forces. However, a notable split soon opened up between radical pro-independence forces (such as the National Independence Party established in 1988) and moderate popular movements (such as the Popular Front). The last Estonian Supreme Soviet, elected in free elections in 1990, was dominated by moderates, while the radicals formed a majority in the Congress of Estonia, a representative body of inter-war citizens and their descendants. In 1991, the two assemblies jointly nominated a Constitutional Assembly that drafted the constitution passed in a 1992 referendum. The divide between the two pro-independence political streams can still be seen in Estonian party politics, especially since the Communist Party disappeared from the political scene. By the early 1990s, the status of the Russian-speaking population – most of whom had migrated to Estonia during the Soviet period, when they enjoyed a more privileged status than the indigenous population – was already a source of disagreement between the two poles. Both the moderates and radicals shared

suspensions about the continued loyalty of the settlers to the Soviet Union and Russia, but the former were keener to reach out and integrate the Russian-speakers. Following independence, the radicals' policies dominated the formation of citizenship and language policies.

The return to independence in 1991 was firmly grounded in restorationist ideas and the principle of legal continuity with the inter-war republic. In particular, citizenship was automatically granted only to the citizens of the inter-war republic and their descendants. A significant portion of the population – mostly those who had moved to Estonia during the Soviet period – had to go through the process of naturalization. Many chose to become citizens of the Russian Federation instead (open to all former citizens of the Soviet Union) or remained stateless (a special status of “aliens” was created by the Estonian parliament). Even though the proportion of Estonian citizens has increased over time, about 7% of population are citizens of a foreign country (mostly the Russian Federation) and 7% remain stateless.

The ethnic divide failed to develop into a full-blown political cleavage, partly because of the limited franchise shared by Russian-speakers. As the support for the ancien régime was relatively low among citizens, the government managed to push through radical economic reforms and to completely re-orientate the country both in terms of its foreign relations and trade patterns. From the early 1990s on, Estonia has determinedly pursued integration with NATO, the European Union and other Western institutions (such as IMF, WTO and OECD). The accession to NATO and the European Union enjoyed a strong elite consensus and determination to conform to the membership criteria. In contrast, euroskepticism among the population was high compared to most other new member states in Central and Eastern Europe. The euroskeptic sentiments were shared by the less well-off, who endured further increases to the cost of living, by hardline nationalists who disputed the sharing of sovereignty, and by many Russian-speakers who were repelled by the rhetoric of turning away from Russia. However, since accession in 2004, public opinion has been increasingly positive about the country's EU membership.

Estonia has followed market liberal economic policies since independence. In the first few years after independence, the country established a free trade regime and underwent a radical privatization program, attracting foreign investors. Following a sharp downturn in the early 1990s, the Estonian economy grew without interruption from 1995 until the recent recession in 2008 by 7.1% a year on average. After the recession, economic growth returned quickly in 2010 and has remained positive despite economic troubles in the European Union. The country joined the WTO in 1999 and, following rapid economic development over two decades, was the first former Soviet republic to join the OECD (in 2010) and the European Monetary Union (in 2011).

Government and party system stability were generally low in 1990s and early 2000s as new parties that had formed shortly before parliamentary elections witnessed remarkable success in 1995 (Reform Party) and 2003 (Res Publica), and a leading party in several 1990s governments (Eesti Koonderakond) disbanded itself in 2000. However, the policies of various governments have been remarkably constant and the party system has recently seen a degree of consolidation. Currently only four parties remain in the parliament and are unlikely to be joined by strong new parties after the 2015 parliamentary elections.

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

Transformation Status

I. Political Transformation

1 | Stateness

Question
Score

The state has a clear monopoly on the use of force across its territory. Currently, there are no extra-legal forces or immediate threats to territorial integrity. Only in early 1990s was there a short-lived risk that Ida-Virumaa (the north-eastern region mostly inhabited by Russian-speakers) could become secessionist in favor of Russia. In the wake of the conflict in Ukraine, Russian military activities have increased in the Baltic region, raising tensions between Tallinn and Moscow. Notably, in September 2014, an Estonian security police officer was abducted by Russian security services on the Estonian side of the border and kept in custody. It remains to be seen whether this constituted an isolated incident or was part of a longer-term challenge to Estonia's territorial integrity.

Monopoly on the
use of force
10

The state enjoys a high degree of legitimacy among both majority and minority ethnic groups. State identity is rarely questioned, even though state legitimacy is generally stronger among ethnic Estonians than Russian-speakers (i.e., ethnic Russians, as well as most other ethnic groups originating in the former Soviet Union). A significant portion of Russian-speakers are either citizens of the Russian Federation or have no citizenship (each group continues to constitute about 7% of the population). The latter group is predominantly composed of former citizens of the Soviet Union who did not automatically qualify for Estonian citizenship in early 1990s and have not undergone naturalization either, mostly because they lack sufficient Estonian language proficiency levels.

State identity
8

Estonia is one of the most secular countries in the world. Although Christian (Lutheran) traditions among the ethnic Estonian majority have a modest conservative influence over culture and politics, their effects are at best indirect, potentially affecting some social attitudes, such as gender equality or the rights of sexual minorities. In 2014, this was manifested by significant mobilization against a new civil partnership law. The bill, however, was eventually narrowly passed by parliament, making Estonia the first country from the former Soviet Union to grant legal recognition to same-sex couples.

No interference of
religious dogmas
10

The state's administrative capacity has increased considerably since independence and the state fulfills all key functions, including the provision of infrastructure, education and health. The quality of services is generally good, even if some may lag behind more affluent neighboring North European countries.

Basic
administration
10

2 | Political Participation

Elections in Estonia are free, fair and meaningful in the sense of determining public policies and filling political positions. The National Electoral Committee is independent and conducts elections in an impartial manner. Following the last parliamentary elections, only four complaints were submitted to the Supreme Court (which resolves electoral complaints), all of which were rejected. Polling is highly accessible as periods of early voting are long and advance voting via the internet has been used since 2005, and twice in parliamentary elections. Internet voting is available for most of the population holding electronic ID cards (also used for other forms of online identification, such as internet banking). Almost a quarter of votes were cast online in the 2011 parliamentary elections and 31% in 2014 European elections. Only registered political parties and independent candidates can contest national elections; in local elections, lists based on citizen alliances are also allowed to stand. All permanent residents, including non-citizens, can vote in local elections. In parliamentary elections, suffrage is limited to citizens, excluding people without citizenship and those holding foreign citizenship.

Free and fair
elections
10

Access to mass media is free to all political parties, but minor parties have often complained about being excluded from the main election debates on public television. Electoral campaigns have become increasingly expensive, giving an advantage to parties that benefit from state subsidies – mostly those already strongly represented in parliament – and are able to attract considerable private donations. In recent years, there have also been a number of accusations concerning the use of administrative resources for election campaigning. These have primarily targeted the Centre Party following the 2013 local elections in Tallinn, but also Prime Minister Rõivas, who shot a campaign clip at a military airbase.

In Estonia, democratically elected power holders have a power to govern without any substantial interference from non-elected veto powers. Government policies have generally been business-friendly, but have not given apparent advantages to any sectors of the economy or individual businesses. Civilian control over the military is well-established and strong. The Lutheran clergy does not exert any political influence, although it commands some influence over public opinion.

Effective power to
govern
10

The Estonian constitution guarantees civic groups full freedom of organization and participation. These rights are protected in practice, and the government has not faced any serious accusations concerning the limitation of freedoms. Registration rules for associations are non-discriminatory and clearly established in the Non-profit Associations Act. At the same time, actual levels of civic activism are generally low and the influence of NGOs on public policy is limited.

Association /
assembly rights
10

Freedom of expression is enshrined in the constitution and unrestricted in practice. In 2014, Estonia ranked 11th in the Press Freedom Index; it has also been consistently ranked highest in Central and Eastern Europe in terms of media freedom by Freedom House, outperforming most Western European countries. Even though legislation introduced in 2010 was criticized for jeopardizing the privacy of media sources, this has not affected the overall level of media freedom.

Freedom of
expression
10

The media – especially the popular public broadcaster – is generally unbiased and represents a wide spectrum of opinions. The Public Broadcasting Council is composed of four members nominated by parliamentary political parties, and four experts selected by the parliament. Ownership of the private media is transparent. The two most popular private television channels are foreign-owned (by the Swedish Modern Times Group and Norwegian Schibsted). Estonian companies Eesti Meedia and Ekspress Group own the main newspapers and the popular internet-based news and entertainment portal Delfi (which also operates news portals in Latvia and Lithuania). The latter has been testing the limits of freedom of expression by pioneering anonymous reader comments on its news stories since the early 2000s. Trust in different media outlets in Estonia is considerably higher than the EU average – particularly regarding television. Some 68% of Estonians tend to trust broadcasters, in contrast to 48% of all EU citizens (according to Eurobarometer, November 2013). In recent years, there have been some instances where the government has been accused of meddling in the editorial freedom of publicly funded media. Notably, the minister of culture had to resign in 2013 following accusations that the appointment of an editor to a government-funded cultural weekly had been politically motivated.

In recent years, increasing concerns have been raised about the lack of Russian-language public media to cater for the Russian-speaking minority. There are some Russian-language newspapers and the public broadcaster runs a Russian-language radio channel. However, in terms of television, channels operating from or controlled by the Russian Federation dominate the non-Estonian airwaves, and the minority population is exposed to misinformation and propaganda. These concerns mounted following the beginning of the Russian-Ukrainian conflict, and in 2014 the Estonian government approved special funding for the creation of an additional Russian-language TV channel set to launch in 2015.

3 | Rule of Law

There is a clear separation of powers in Estonia with mutual checks and balances generally working well. The judicial system is independent of the executive and administration is largely free from unjustified party political pressure. Due to the parliamentary nature of the political system, the executive and legislative powers are fused, with the former dominating the latter. For example, the staff of the parliamentary research department prepared only six studies in 2013/14 to support the parliamentary scrutiny of government policies by the deputies. Parliamentary committees are entitled to request information and responses to questions, and have pressed the government to provide documents or send ministers to be interviewed by the deputies. The task areas of committees generally coincide with the portfolios of ministries, supporting an effective parliamentary oversight. Parliament has regularly debated the government's policy proposals, for example, on the reform of the support system for persons with disabilities or on the highly controversial law permitting partnerships of same-sex couples.

Separation of
powers
10

The Estonian courts are independent and free both from executive intervention and, by and large, from corruption. Judges of the first and second instance are appointed for life by the president on the proposal of the Supreme Court. Justices of the Supreme Court are appointed by parliament upon nomination by the chief justice, who is appointed in turn by the parliament upon nomination by the president. The Supreme Court also fulfills the functions of a constitutional court. Requests for constitutional review can be initiated by the president, lower courts or the chancellor of justice. The system of judicial review is well-established, the Supreme Court regularly declares legal acts unconstitutional and monitors the implementation of its rulings by the parliament. For example, the Constitutional Review Chamber declared a legal act wholly or partially unconstitutional in ten out of 18 cases reviewed in the first four months of 2014.

Independent
judiciary
10

Estonia is widely considered to be the least corrupt country in Central and Eastern Europe. Political and administrative corruption are not widespread and are effectively penalized. Perceptions of corruption trends are more positive than elsewhere in Europe. According to Eurobarometer data from February 2014, Estonians were the least pessimistic about corruption across Europe. Only 31% of respondents saw an increase in corruption levels in the last three years and 15% noted a decrease (the corresponding EU averages stood at a 56% and 7%). Almost a third of Estonians believed that the government's efforts to combat corruption were effective, against only 23% elsewhere in the European Union. A number of high-profile corruption cases have been brought to the courts in recent years. In 2014, two former government ministers as well as a former head of the Estonian Land Board were all found guilty and received a custodial sentence in a landmark case concerning illegal land swaps carried out during the 2000s.

Prosecution of
office abuse
9

The Estonian constitution bans discrimination based on nationality, race, sex, language, religion, political opinion and social status. These rights are respected by state institutions, and the protection of individuals is effective. Apart from the court system, there are two national institutions whose key functions include the protection of civil rights. The chancellor of justice monitors the protection of fundamental rights and freedoms, performing the function of an ombudsman in addition to his role in constitutional review. The Gender Equality and Equal Treatment Commissioner (GEETC) monitors compliance with regulations concerning gender equality (enshrined in the Gender Equality Act and Equal Treatment Act). Both institutions have generally maintained independence from the government and have been effective. The very limited funding received by the GEETC has been criticized in recent years, but its budget was boosted in 2013 by a Norwegian assistance project that increased the staff from just one to seven. Growing tensions with Russia have the potential to affect the relationship between ethnic Estonians and Russian-speakers by raising mutual distrust. This could trigger ethnic discrimination or even violence, but there is currently little evidence of that.

Civil rights
10

4 | Stability of Democratic Institutions

Democratic institutions are robust and follow the procedures established by the constitution and other legal acts. Some tensions that exist between branches of government, and particularly between national and local government (especially the capital city, led by the opposition Centre Party) occasionally surface, but never to the detriment of democratic governance.

Performance of
democratic
institutions
10

Democratic institutions are widely accepted as legitimate by all centers of political power and non-governmental associations. There are only very minor examples of political players questioning certain democratic procedures. For example, the Centre Party has repeatedly challenged the legitimacy of internet voting. After the 2011 elections, it filed a complaint to the Supreme Court, but was turned down.

Commitment to
democratic
institutions
10

5 | Political and Social Integration

The party system has been fairly stable since the 2003 parliamentary elections, when a major new party, Res Publica, achieved unprecedented success and formed a government. During the 2011 parliamentary elections, no new parties entered the parliament. Only four political parties were represented. Fragmentation and electoral volatility declined in comparison with the 2007 elections. At the same time, the party system is fairly polarized, because the controversial and autocratic long-time leader of the Centre Party, Edgar Savisaar (also the mayor of Tallinn), is all but incapable of forming coalitions with other parties.

Party system
9

All of the main political parties have developed strong organizations, including efficient central offices and local branches. The party central offices tend to dominate the parliamentary groups, which are highly disciplined. There is only a limited tradition of extensive or genuine intra-party democracy either in terms of policy formulation or candidate selection. Internal conflicts have sometimes led to centrifugal tendencies. In 2014, the Free Party was established mostly by former members of the IRL after the latter had suffered from an internal conflict between factions following its merger in 2006. The Centre Party has for a long time seen repeated defections by members frustrated with the dominance of party leader Edgar Savisaar. Seven of its 26 members of parliament elected in 2011 had left the party before the end of the parliamentary term.

Even though freedom of organization is granted by the constitution and in practice, civil society has been weak. On one hand, the number of active NGOs is low. On the other hand, those that do attempt to influence the political process have limited sway. The Estonian Trade Union Confederation is comprised of 20 union branches. In comparison to many Western European countries, its policy-formulating capacity is very weak. Trade unions are typically invited to contribute to the policymaking process initiated by the government. The Estonian Employers' Union has been more active (and even aggressive) in making policy proposals, especially in tax policy and industrial policy. Yet, their institutional and analytic capacity is not significantly higher than that of trade unions.

Recent years have seen moderate increases in the activities of trade unions and pressure groups. Remarkable examples from 2014 include mobilization by groups for and against legal recognition for same-sex couples as well as the rushed introduction of reforms to Estonia's system of occupational disability benefits. In general, the government has been fairly dismissive of the political activities of interest groups, often arguing that views ought to be expressed at the ballot box and through political parties rather than protests and lobbying. Characteristically, interest groups often direct their appeals to the (largely ceremonial) president, calling on him to veto laws passed by what they see as an unresponsive parliament.

In Estonia, support for democratic norms and democratic political institutions is fairly high, but it lags behind levels that exist in countries with a longer experience of democracy. Popular satisfaction with the way democracy works in Estonia is close to the EU average. According to a 2013 Eurobarometer survey, 40% of Estonians were satisfied with the workings of democracy in their country, slightly lower than the EU average of 48% and one of the highest among the Central and East European member states. Trust in national institutions in 2013 – even before the new Rõivas government took office and a honeymoon effect set in – was among the highest in Central and East Europe. Estonians trust national and local government as well as parliament (at 38%, 57% and 35% respectively) significantly more than the EU average (23%, 44%

Interest groups
9

Approval of
democracy
10

and 25%). Trust in political parties is low, but still exceeds the EU average (respectively 16% and 14%).

According to the 2012 European Social Survey, 85.2% of Estonians considered it important to live in a democratically governed country, three percentage points less than the average of 28 European countries and Israel, but two percentage points higher than the unweighted average of 12 post-communist countries. Levels of trust in the legal system and police are above levels in all other post-communist countries and many South European countries. The military and rescue services are trusted by more than 80% of the population, thus making them the most trusted institutions in the country.

Levels of interpersonal trust in Estonia are high compared to other post-communist countries and many Western European countries. According to the 2012 European Social Survey, 40% of Estonians reported that they trust others (seven or above on a ten-point scale where ten stood for “Most people can be trusted” and zero for “You can’t be too careful”) compared to an average of 22% in the 12 post-communist countries included in the survey. Levels of volunteering were low by Western European standards and average by Central and East European standards, as three-quarters of respondents said that they had not volunteered in the last 12 months.

Social capital

9

II. Economic Transformation

6 | Level of Socioeconomic Development

Estonia has reached a very high level of human development according to United Nations’ Human Development Index. It ranks 33rd in the world, above most Central and East European countries except for Slovenia and the Czech Republic. Income inequality as measured by the Gini index is slightly above the EU average (32.7 versus 30.7 in 2011), but has decreased in recent years. The level of absolute poverty has been low but still ranks among the highest in Central and Eastern Europe (1.4% of population living on under \$2 a day PPP in 2011). Relative poverty – measured as the share of population on income below 60% of the national median – was 21.5%, close to the EU average but among the lowest in Central and Eastern Europe in 2013. Relative poverty was some nine-percentage points higher among ethnic minorities than ethnic Estonians and particularly high in North-Eastern Estonia (34%), predominantly inhabited by Russian speakers.

Question
ScoreSocioeconomic
barriers

8

Gender inequality in terms of the multi-dimensional UNDP Gender Inequality Index is similar to that of Central and East Europe. While Estonia ranks among the top countries in the region in terms of female labor force participation, it is dragged down

by the widest (and still increasing) gender pay gap in the European Union (29.9% compared to the EU average of 16.5% in 2013 according to Eurostat). Enrolment levels of both girls and boys in primary and secondary education are good, and higher tertiary education attainment is better than the EU average (43.5 versus 36.2 amongst 25–34 year-olds in 2013). Notably, Estonia has one of the highest shares of female university students across the European Union (59.2% in 2012).

Economic indicators		2005	2010	2013	2014
GDP	\$ M	14003.5	19482.3	24880.3	25904.9
GDP growth	%	9.5	2.5	1.6	2.1
Inflation (CPI)	%	4.1	3.0	2.8	-0.1
Unemployment	%	7.9	16.9	8.8	-
Foreign direct investment	% of GDP	22.3	10.5	3.6	6.2
Export growth	%	19.9	24.0	2.4	2.9
Import growth	%	16.7	21.2	3.3	2.5
Current account balance	\$ M	-1386.4	390.9	-279.3	2.4
Public debt	% of GDP	4.5	6.5	9.9	10.4
External debt	\$ M	-	-	-	-
Total debt service	\$ M	-	-	-	-
Cash surplus or deficit	% of GDP	1.9	0.0	-	-
Tax revenue	% of GDP	15.9	15.7	-	-
Government consumption	% of GDP	16.8	20.1	19.1	19.6
Public expnd. on education	% of GDP	4.8	5.5	-	-
Public expnd. on health	% of GDP	3.9	4.9	4.5	-
R&D expenditure	% of GDP	0.93	1.62	-	-
Military expenditure	% of GDP	1.9	1.7	1.9	2.0

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

7 | Organization of the Market and Competition

Since independence, Estonia has pursued liberal free market policies. Foreign investments are actively encouraged, first and foremost by an attractive tax regime, in which re-invested profits are exempted from corporate income tax. Tax revenues as a share of GDP have been below the EU average since 1997 (33% versus 41% in 2012). Market access is generally free and entry costs are low. According to the 2015 Doing Business report, establishing a company in Estonia takes, on average, four procedures and four and a half days, and the average costs of registration are 1.4% of Estonia's per-capita income. Prices are fully liberalized. Estonia fully complies with international standards for the equal treatment of companies. Entry and exit barriers to product, factor and capital markets are low or do not exist. The country has been firmly committed to the principle of balanced budgets and currency stability. According to estimates published by the Stockholm School of Economics in Riga in 2014, the size of the informal economy in Estonia decreased from 20% of GDP (2009) to 16% of GDP. Undeclared business revenues and wages are mainly earned in the construction sector.

Market-based
competition
10

As an EU member state, Estonia has developed a comprehensive legal framework to prevent monopolistic structures and conduct. It is one of the few European countries to impose criminal sanctions on some antitrust infringements (the range of which was narrowed in 2015). The regulations are enforced by the Estonian Competition Authority that has divisions working on competition (including mergers and railways), and energy and water. In recent years, it has carried out inspections on energy, pharmacies and central heating, among others.

Anti-monopoly
policy
10

Estonia's foreign trade is highly liberalized and the country enjoys membership in the WTO (since 1999) and the European Common Market (2004). The annual volume of exports and imports is close to 90% of the country's GDP.

Liberalization of
foreign trade
10

Estonia has implemented most of the European Union's banking and finance regulations, including the Basel II Capital Requirements Directives. Its 11% capital-to-assets ratio is higher than the Basel II minimum requirement. According to an April 2014 IMF report, the Estonian authorities are implementing the new capital and liquidity provisions under Basel III. The banking sector is competitive, and dominated by foreign-owned banks. The main banks are subsidiaries of Swedish (Swedbank with 42% market share and SEB 20%), Finnish (Nordea 16%) and Danish (Danske Bank 11%) firms. There are no state-owned commercial credit institutions. The European Central Bank began to supervise Estonia's three largest banks (SEB, Swedbank and DNB) in November 2014, when the Single Supervisory Mechanism was implemented in the euro zone. Other subsidiaries of Swedish and Danish Banks are supervised by Swedish and Danish authorities. The share of non-performing loans

Banking system
10

that began to increase after the onset of the 2008 financial crisis (and peaked in 2010 at 5.4%) has returned to very low levels, well below the EU average (1.5% and 7.9%, respectively). Total household debt is still very high at 97% of gross disposable income, following a sharp increase before the economic recession (OECD).

8 | Currency and Price Stability

During the last two decades, Estonia has often faced the challenge of controlling inflation. Annual change in consumer prices has remained below 11% since 1997, but levels of inflation have become volatile following economic cycles. Recently, the country has moved from galloping inflation in 2008 (10.4%) to deflation in 2009 (-0.1%), back to modest price rises (2.8% in 2013). Kroon, the national currency from 1992 until the adoption of the euro in 2011, was from its inception pegged to the German mark (and later the euro). With the adoption of the euro in 2011, independent foreign exchange policy ceased to exist; however, it was limited even before this point because of a fixed peg between the national currency and the euro.

Anti-inflation /
forex policy
10

Estonia has one of the most prudent public finance systems in the European Union. It has the lowest public debt ratio of all European countries by some distance: 9.8% of GDP in 2013, compared to 16.4% in Bulgaria (the second lowest) and the EU average of 85.4%. Estonian governments have pursued conservative fiscal policies. State budgets have generally been balanced and often in surplus. During the recent financial crisis, the budget went into deficit (-3% of GDP in 2008) but has since returned to balance. In March 2014, the parliament adopted a new state budget law that obliges the government to prepare structurally balanced budgets and creates an independent fiscal council attached to the Bank of Estonia. The council assesses the extent to which the Ministry of Finance provides realistic fiscal and macroeconomic forecasts and follows the budgetary rules in its annual budget drafts. As the government has built up significant state reserves, the government can usually cover a deficit without borrowing. Estonia's current account balance turned positive during the recession, but has generally been negative, most recently -1.2% of GDP in 2013.

Macrostability
10

9 | Private Property

Property rights are enshrined in the constitution, widely observed and effectively enforced by the courts. Expropriation follows clearly established rules and compensation is based on market values. The treatment of foreign and domestic capital is equal and there is no discrimination against foreign ownership.

Property rights
10

The private sector dominates the Estonian economy. A radical post-independence privatization program was carried out by the mid-1990s, and currently only a small number of strategic companies (such as the port of Tallinn, major power plants, the railways and the postal system) remain in state ownership. Estonian Air, the struggling national airline, was re-acquired by the government in 2010, but in 2014, a plan to privatize it into an Estonian business group was announced. Private enterprises benefit from business-friendly economic regulations and a highly flexible labor market. For example, during the recession, wages proved to be highly responsive to the deteriorating economic environment.

Private enterprise
10

10 | Welfare Regime

Estonia has developed a comprehensive welfare system based partly on cash transfers from the state budget and partly on insurance payments. Health care and most pensions are funded by a 33% social tax on payroll that is paid by employers. Health care is funded through a national Health Insurance Fund that also covers the cost of services to most non-working people. However, there are some issues with the coverage of health services as some groups are not insured (adults who neither work nor receive of social benefits). The total public spending on health (4.7% of GDP) is much lower than the EU average (7.9%), but comparable across Central and East European member states.

Social safety nets
9

The pension system is based on three pillars: state pensions, mandatory funded pensions invested in private pension funds and private supplementary pensions supported by tax incentives. A reform of the pension system in 2002 established the second pillar to ease the future budgetary burden given the increasing ratio of elderly. Compulsory payments into this system were suspended during the recession, but were resumed gradually in 2011 and 2012. The share of state contributions will actually be raised from 2015.

Parental benefits and unemployment insurance outlays are relatively generous. The parental benefit amounts to 100% of a person's prior salary and is paid for up to 19 months (including pre-natal leave). Unemployment insurance benefit is paid for up to one year with the initial replacement rate at 50% (this drops to 40% after the first 100 days). To finance the increased payments that occurred during the recession, the unemployment insurance tax increased to 4.2% in 2009 but was reduced to 3% in 2013.

Other social benefits are significantly less generous as the levels of income redistribution are low. Both the average monthly old-age pension and the minimum wage were around 350 Euros in 2014. The unemployment benefit for those not qualifying for insurance payments is less than half of the minimum wage and paid for less than one year. The levels of family, disability and subsistence benefits are

also generally low, but have seen some increases in recent years. In 2015 the monthly child benefit increased by more than twofold to €45, rising to €100 from third child on.

The Estonian Constitution guarantees equal opportunities regardless of social status, religion or ethnicity. Male and female enrolments are very high in primary and secondary education, while women greatly outnumber men among university students. Estonia also boasts the highest female employment level in Central and Eastern Europe (70% in contrast to the EU average of 63% in 2013), albeit controversially accompanied by the highest gender pay gap in the European Union (30%, while the EU average was 17% in 2012).

Equal opportunity
9

The status and future of the Russian language in secondary education has been a contentious issue since independence. Since 2011, all secondary schools must teach at least 60% of the curriculum in the Estonian language (education prior to the age of 16 can still take place fully in Russian). On the one hand, this ought to increase Russian-speaking children's Estonian language proficiency and enhance their educational opportunities and career prospects. On the other hand, concerns have been raised about a very sizable ethnic minority losing the right to education in its native language (Russian is the first language for about 25% of the population). Significant opposition to the law concerning Estonian language in schools and the government's refusal to grant exceptions was raised by representatives of the Centre Party in the Tallinn city government, which has also tried to continue with Russian-only teaching in some schools using legal loopholes.

According to the Language Act, a certificate of Estonian language proficiency is required for certain public and private positions (e.g., doctors, nurses, lawyers, police officers and various transport workers). The requirements may reduce the opportunities for some Russian-speakers, even though most of the requirements are well justified in terms of ensuring the quality of services and public safety. Still, national statistics suggest that ethnic non-Estonians are at a greater risk of unemployment. During the recession, unemployment peaked at 23.4% among minorities and at 13.5% among ethnic Estonians. The gap decreased, but persisted after the economic recovery and was 5.6 percentage points in 2013.

The parliament legalized same-sex partnerships in principle in 2014 by reaching a narrow majority following heated debates. Provisions implementing this decision, however, remained to be passed by the new parliament elected in 2015.

11 | Economic Performance

Following a robust recovery in 2011 – 2012 from deep recession, economic growth stalled somewhat in 2013 and 2014. At 1.6% and 1.9% respectively, it was better than the zero growth recorded across the European Union, but more sluggish than that of its southern neighbors Latvia (4.2%, the highest in the European Union) and Lithuania. Some increase in GDP growth was forecast by the OECD for subsequent years, although uncertainty remained thanks to low growth forecasts for Europe and political instability in Russia and Ukraine.

Estonia has ranked among the countries with the highest levels of inflation in most of the years following its 2004 accession to the European Union. This level declined significantly during the recession and remained below 4% in 2012/13. Unemployment increased considerably during the recession, when Estonia saw some of the European Union's highest levels of joblessness (16.9% in 2009). By 2013, this figure was back down to 8.6%, below the EU average of 10.8%.

In contrast to pre-recession years, economic growth has recently been less related to the inflow of foreign capital than to increasing domestic demand (resulting from above-growth wage increases). FDI peaked in 2007 at 15.4% of GDP, and even though it picked up quickly after the recession, this figure remained at 3.9% in 2013 (albeit still above the European Union and Central East European averages).

12 | Sustainability

Estonia's environmental performance has improved in recent years according to the Environmental Performance Index. In 2014, it was ranked 20th in the world and was one of the top ten trend performers.

The country scores very highly for pesticide regulation, biodiversity and habitat protection (top performer worldwide), and highly for health impacts and air quality. The country's performance is less exemplary in terms of the overexploitation of fish stock, declining forest cover and increasing carbon intensity. Several recent developments evidence a will among government to improve the country's ecological credentials; these may lead to improved outcomes in the near future. A third of energy consumed in Estonia is used in buildings, and the government has developed an ambitious program for the renovation of residential housing. Likewise, many other environmental projects have been funded from the auctioning of Estonia's excess Kyoto CO2 quota. These proceeds have been used for a Green Investment Scheme that has funded the renovation of heating networks, combined generation plants, the promotion of public transport (including alternative fuels and electric transport), electric cars for social workers and investments in wind energy. In 2012, 26% of energy consumed in Estonia came from renewable sources.

Output strength
9

Environmental
policy
9

Education enrolment levels and the general quality of education are high in Estonia. The level of public spending on education is close to the EU average and among the highest in Central and Eastern Europe (5.2% of GDP in 2011). Expenditures on R&D more than doubled between 2003 and 2012 (from 0.8% to 2.2% of GDP). They are now close to the EU average (2%) and fall behind only Slovenia among Central and East European countries. Estonia has a vibrant digital economy sector and is the most knowledge-intensive of the Central and East European countries. Around a third of total exports to other EU countries involve hi-tech products and services, but the country still produces mostly low- or medium-level technological goods. Also, despite increases in R&D spending, collaboration between research institutes and enterprises (particularly small- and medium-sized enterprises or SMEs) is suboptimal. The government has pioneered several digital initiatives in the public sector, for example, electronic medical records, internet voting and online tax returns. In 2014, Estonia established a system of e-residency by issuing to non-residents electronic ID cards akin to those used by residents. These can be used for a wide range of purposes, including managing businesses, giving electronic signatures and facilitating online self-identification.

Education policy /
R&D
9

Over the years, Estonian governments have been committed to supporting innovation and education, although extra funding has not always been forthcoming. Teachers' salaries increased over two consecutive years (by almost 20%) following a general strike among educators in 2012. From 2013, the government eliminated all fees for university students, accompanied by increased funding for higher education teaching and student support. The full impact of the reform remains to be seen, particularly whether access for students from less affluent socioeconomic backgrounds has improved.

Another major challenge the country has faced since 2011 is managing a downsizing of schools and higher education institutions across the country due to rural out-migration and smaller cohorts of university-age students. Many rural schools were closed or merged between 2012 and 2014, while universities sought to consolidate degree programs, departments and research teams.

Transformation Management

I. Level of Difficulty

The government does not face any severe structural constraints that limit governance capacity. Education levels among the population are high, extreme poverty is rare and disease levels are low. While Estonia is located fairly far from populous Western European countries, it has access to the sea and enjoys proximity to the affluent Nordic countries, particularly Finland. However, the population is concentrated in a limited number of urban centers, the distances between which are fairly high given the low overall population density. This poses challenges in terms of infrastructure and rural development. Significant labor out-migration – particularly to Finland – following the country's accession to the European Union in 2004 is another key challenge. The movement of labor has created new social problems (e.g., children being left behind by parents working abroad). These may lead in the longer term to decreasing human capital (brain drain) and an increasing elderly dependence ratio. Rising tensions between Estonia and Russia in the wake of the Ukraine conflict may adversely affect some sectors of economy, such as the agriculture and food industries (which suffer from Russian import restrictions) as well as tourism (Estonia has been a popular destination among Russian tourists). However, the overall share of Russia in Estonia's foreign trade was quite limited (11% of exports and 6% of imports in 2013).

Structural
constraints

2

Estonian civil society may be weak when compared to its Nordic neighbors, but it is better developed than in most other former communist countries. For example, Estonia boasts the highest level of inter-personal trust in Central and Eastern Europe. Various civil society organizations (CSOs) participate actively in public life. Such associations have become more numerous and active since the mid-1990s due to the enabling effect of economic growth and certain policy initiatives. Guidelines for public funding of civil society projects and studies through the National Foundation of Civil Society were adopted in 2013. In 2013/14 a new Civil Society Development Concept was prepared, and was approved by the government in early 2015.

Civil society
traditions

2

According to a study by the Centre for Civil Society Research and Development at Tallinn University, 31% of the Estonian population are members of civic organizations, slightly more than half of them active. However, sports, recreational and cultural organizations dominate and only 20% of the population is engaged in

political activities such as contacting officials, signing petitions or campaigning for a cause. However, recent years have seen an increase in social and political activities by CSOs – often outside of the institutional framework provided by the government. While trade unions have generally not been particularly active in Estonia, recent years have seen a number of strikes (e.g., by teachers and doctors). Other forms of social protests have also become more common, ranging from protests against the Anti-Counterfeiting Trade Agreement (ACTA) to virtual mass petitions demanding changes to party and electoral regulations, debates against disability work reform, and for and against the legalization of same-sex partnerships.

While the style in national and local politics is often confrontational, there have been almost no instances of violent political conflict. There has been very limited mobilization on ethnic grounds, apart from the 2007 Bronze Soldier episode, when groups of Russian-speakers rioted as the government was about to relocate a controversial World War II monument from central Tallinn to a military cemetery. In recent years, the education reform that requires all secondary schools to teach 60% of the curriculum in Estonian, has created tensions between the government and the Tallinn city government. The Centre Party that governs the ethnically split capital and represents the bulk of the country's Russian-speaking minority has been vocal in its opposition to the reform. Several prominent Russian-speaking Centre Party politicians have also sued the Estonian Security Police Board for mentioning their anti-reform activities in its yearbooks and accusing them of promoting Russia's controversial compatriot policies. The party has also toned up its rhetoric, which had previously derided the credibility of the Estonian government, Security Police Board or other agencies on occasion.

Conflict intensity
3

II. Management Performance

14 | Steering Capability

Governments in Estonia have been able to set priorities and maintain them over time thanks to high levels of political stability. Key policy priorities have included a prudent fiscal policy and a knowledge-based economy. The Ansip government has adopted an action program that is updated annually and structured into seven priority areas covering 55 objectives in 18 different fields of policy.

Two different bodies, the government itself and independent experts, monitor the program and assess the government's performance in implementing it. When Prime Minister Andrus Ansip (Reform Party) stepped down in March 2014 to be nominated for a post in the European Commission, he had been in office for nine years and had

Question
Score

Prioritization
9

become the longest-serving prime minister in Europe. His party has been a continuous member of the governing coalition since April 1999. In 2014 (in conjunction with Ansip's resignation), the Reform Party replaced its three-year coalition partner, the IRL, with the SDE, and introduced a new coalition program for a single year before the 2015 parliamentary election. Still, the change of government barely affected long-term policies, as national development strategies and plans were well-established, as were the procedures for budgetary planning and impact assessment. However, it is worth noting that some important reforms have stalled for extended periods because of a lack of political will or contrary pressures. For example, changes needed to make more efficient Estonia's local governments (many of which are poor and tiny) have been debated for more than a decade, yet very limited progress has been made.

Governments have been effective in implementing policies, as nearly all governing coalitions have enjoyed a parliamentary majority and have benefited from a high degree of party discipline. Also, coalition partners generally abide by the policies agreed in the coalition agreement, but challenges have arisen during times of crisis or in the run-up to elections. For example, in 2009, the Reform Party clashed with one of its partners, the SDE, over the measures to be taken amid the economic crisis, and eventually Prime Minister Andrus Ansip dismissed them from the coalition. Likewise, after the Reform Party and the IRL had governed for three years together, tensions between the partners boiled over and in March 2014, the latter was replaced by the SDE. Thus, no cabinet has survived a full four-year term in office. Nevertheless, governments have been able to balance the state budget, thanks to the center-right profile of most coalitions. Controlling inflation has proved to be more challenging; the weakness of the Estonian government's counter-cyclical policies has often been criticized.

As a member state of the European Union and OECD, Estonia is thoroughly integrated into international networks of policy exchange. Hence, policymakers are continually exposed to new and different ideas. The volatile economic conditions from 2008 – 2011 demanded a particularly high degree of policy flexibility. Regulatory impact assessment procedures are well-established, cover an increasing number of legal acts and require the involvement of relevant interest groups and public consultations in the lawmaking process. There is a strategy unit at the Government Office, but it has limited capacity and impact. The government relies on external academic advice, but the extent to which scholarly findings and recommendations influence policy proposals varies greatly. On the downside, Estonian policymakers often appear to be stubborn, and changing one's mind is generally seen as a sign of weakness, which somewhat reduces the scope for policy learning.

Implementation
9

Policy learning
8

15 | Resource Efficiency

Estonian public administration is generally efficient. There is little political interference in administrative appointments, although some top positions have become politicized in the last decade, principally county governors, nearly all of whom are now members of the ruling political parties. Estonian governments adhere to the principle of balanced budgets and as a consequence, the country has the lowest level of government debt in Europe. Actual state budget expenditures deviate little from planned expenditures, apart from during the years of economic boom and recession. Estonian governments have made efficiency savings by pioneering e-governance and introducing a very wide variety of online services both to individuals and businesses. Extensive use is made of electronic chip-embedded ID cards – held by nearly all adult Estonians – which can be used for securely identifying individuals online. In 2014, the technology and services were made available globally when Estonia started issuing ID cards to non-resident applicants (dubbed e-residents).

Efficient use of assets

9

The National Audit Office is an independent constitutional institution that monitors the use of budgetary resources by the state and local governments through both financial and performance audits. It has provided rigorous critique of administrative practices, the failure of state innovation funds to boost economic development and the use of public resources for party political campaigns.

Even though the prime minister and one of the coalition partners changed in 2014, the government has generally been united behind the policies proposed in the coalition agreement. There is little public friction about policies, not least because of the small size of the country, which allows an ironing out of disagreements in private. The Government Office operates a Strategy Unit that supports work planning within the cabinet, and coordinates implementation of the government's action plan as well as strategic development plans. However, the high number of individual strategic documents (54) can sometimes hinder effective coordination.

Policy coordination

9

The government has a high degree of transparency, allowing citizens and the media access to information. In recent years, Estonia has amended a number of anti-corruption laws, such as the Political Parties Act, the Public Service Act and the Anti-Corruption Act, partly in response to concerns raised by the Council of Europe's Group of States against Corruption (GRECO). However, challenges remain, the most important of which are related to party funding. International organizations such as the European Union and the OECD have also highlighted corruption risks within public procurement procedures, the overlooking of foreign bribery cases by the legal system and an insufficient regulation of lobbying. To address the latter issue, a code of ethics for members of parliament was approved by parliament in late 2014.

Anti-corruption policy

9

The regulation of party financing has been a particularly controversial issue in recent years. The leader of the opposition Centre Party, Edgar Savisaar, has been accused of accepting funding from Russian Federation business interests in exchange for political influence. As mayor of Tallinn, Savisaar has also been criticized for using municipal funds for party political campaigns. Meanwhile, in 2012, the Reform Party was accused by a former member of parliament of having funneled donations from anonymous sources through other members of parliament and party members. Such scandals have led to increased calls for party financing reform. The Estonian Party Financing Monitoring Commission was set up in 2011, comprising representatives from the parliamentary parties and members nominated by the Chancellor of Justice, the National Audit Office and the National Electoral Committee. The committee reviews regular financial reports from political parties, electoral alliances and single candidates. The new commission was an improvement over the previous system, in which campaign expenditure reports were submitted to a committee composed only of members of parliament. Still, the effectiveness of the committee is limited as it lacks the resources to check on the validity of submitted reports, and its leeway is potentially limited because political parties provide a majority of its members.

16 | Consensus-Building

Representative democracy is uniformly accepted by all the political actors of any relevance.

Consensus on goals
9

Liberal market economy enjoys a broad consensus among the major political actors in Estonia. Center-right governments have been in power most of the time since independence in 1991; they have generally followed neo-liberal economic policies involving balanced budgets, low public borrowing, a flat-rate income tax and currency stability. It should be noted that even the two center-left parties currently represented in parliament, the opposition Centre Party and the SDE who joined the coalition in 2014, agree with these fundamental objectives in broad terms. Nevertheless, the two parties also call for the development of stronger welfare safety nets, and all parties except for the Reform Party now advocate some form of progressive taxation, including the conservative IRL since 2014.

There are no anti-democratic political, military or economic actors with any significant voice or power in Estonia.

Anti-democratic
actors
10

The main social cleavage is between the ethnic Estonian majority (69% of population) and a sizeable Russian-speaking minority (25%). The communities often live separate lives and are divided by latent issues, such as interpretation of the Soviet occupation or increasing tensions between Russia and the West. However, the cleavage is only partially politicized, as ethnic Russian parties have been weak and unrepresented in the national parliament since 2003. Russians are mostly represented by the Centre Party, which has been very successful in building up support among the minority community by controlling municipal government in Tallinn and in north-east Estonia, where most Russians live. Sometimes this has led to sharp confrontation with the governing parties, which are almost entirely ethnic Estonian. However, in 2014, the first ethnic Russian minister not representing the Centre Party (Jevgeni Osinovski, SDE) assumed office at – significantly – the ministry of education and research. The SDE also convinced the small Russian Party of Estonia to merge with it in 2012 as part of an effort to make headway among Russian-speaking voters. Still, the party had mixed success during the 2013 local elections.

Cleavage /
conflict
management
7

Civil society actors have become increasingly active in politics. In the last five years, several trade unions have staged national strikes, prominent intellectuals have called for democratic reforms, and protesters have campaigned for and against the legalization of same-sex partnerships, disability work reform and ACTA. Even though many CSOs are vocal and constructive, their activities are sometimes seen by the government as a nuisance and an obstacle to effective governing. However, the government does respond to pressures, even though direct involvement of CSOs in the decision-making process remains somewhat limited. In 2012, a group of prominent public intellectuals issued a document entitled Charter 12, calling for the strengthening of democracy in response to a party-funding scandal surrounding the governing Reform Party. A People's Assembly, or online platform for crowd-sourcing reform proposals, was set up after Estonia's president convened a national political roundtable. In April 2013, 300 citizens, randomly drawn from a pool of applicants, discussed proposals for amending the party financing system, the electoral law and other democratic reforms. 18 proposals were selected and presented for discussion to the parliament by the president. However, the parliament was later criticized for watering down most of these. The process itself was also criticized by many for having been elite-led and limited in terms of the range of reforms considered.

Civil society
participation
9

The political leadership recognizes the need to deal with historical acts of injustice, but Estonia has not implemented an extensive program of lustration. Interpretation of historical events and periods such as World War II, the Soviet occupation and collaboration with the Soviet power structures are of some contemporary political relevance. The events of World War II, in particular, are a frequent source of disagreement between the majority of ethnic Estonians (especially the political elite) and many Russian-speakers, as many of the latter maintain pride in the role of the

Reconciliation
8

Red Army, while the former mostly see it as an occupying power that refused to withdraw from Estonia at the end of the war. Two initiatives from Estonia's presidents have sought to reconcile Estonians with their past: the establishment of the Estonian International Commission for Investigation of Crimes Against Humanity by Lennart Meri in 1998, and the Estonian Institute of Historical Memory (focusing mostly on human rights during the Soviet period) by Toomas Hendrik Ilves in 2008.

17 | International Cooperation

Estonia has benefited from generous assistance from the EU's Structural Funds. This has amounted to about 3% of GDP annually during the 2007 – 2013 financial period, with a similar budget allocated for 2014 – 2020 (the ratio to GDP will decrease somewhat due to economic growth). Prioritized activity fields include energy, entrepreneurship, administrative capacity, education, information society, environmental protection, regional development, R&D, health care and welfare, transportation, and the labor market. The use of structural funds is linked to long-term strategic plans adopted by the parliament and the government, which are generally well-coordinated between ministries.

Effective use of support
10

The government is seen internationally as highly trustworthy. Estonia has been ranked among the most credible countries in Central and Eastern Europe by international credit rating agencies (rated A+ by Fitch alongside the Czech Republic and Slovakia). Estonia is widely seen as an EU member state that is successfully and tenaciously abiding by nearly all EU norms. Government officials are often openly critical of countries such as Greece that do not follow these rules as meticulously.

Credibility
10

Since independence, Estonia has been involved in various forms of international cooperation. In the years immediately after independence, cooperation was most active with other Baltic countries, but later the emphasis shifted to cooperation with the Nordic countries and the Baltic Sea region as a whole. This tendency was further strengthened during the process of EU accession. Currently, cooperation within various EU frameworks is a priority, and more narrowly defined regional cooperation has lost some of its earlier importance.

Regional cooperation
10

Still, in recent years, the Baltic states have made joint efforts to increase their energy security. Three issues in particular have added a sense of urgency to this matter: (a) the closure of a Soviet-era nuclear power plant in Lithuania in 2009, (b) the long-term infeasibility of oil shale-based electricity production in Estonia, and (c) the perception that excessive reliance on Russia for energy is undesirable. A plan to jointly finance the construction of a new nuclear power plant in Lithuania has been one of the key projects, but very little progress has been made, particularly since 2012 when a consultative referendum in Lithuania turned down the idea. Regional cooperation has been more successful in terms of diversifying gas supplies through

the development of liquid natural gas (LNG) terminals that should end the pipeline monopoly enjoyed by Russia's Gazprom. Recently, a floating terminal was opened in Lithuania that could, in principle, cover most of the natural gas needs of the Baltic states. Also, there are plans to build an undersea pipeline that would connect Estonia to the Finnish natural gas grid, including a prospective LNG terminal in Finland. In 2014, the second stage of Estlink, an underwater power cable between Estonia and Finland, was completed, further integrating the two countries into Nordic electricity markets.

Relations with the Russian Federation have been increasingly difficult, especially in the wake of the "Bronze Night" troubles of 2007, a failure to sign a border treaty between the two countries after 20 years of Estonian independence and the significant worsening of relations between Russia and the West in 2014. There was renewed optimism concerning the border treaty after it was signed again in 2014 (Russia had withdrawn its signature in 2005). However, it remains unratified at the time of writing.

Strategic Outlook

Estonia faces few critical challenges in the short- and medium-term. A lack of support for anti-system parties and widespread approval of democratic principles make political instability unlikely. Support for the four parliamentary parties has remained fairly stable since the 2011 parliamentary elections. The 2015 parliamentary election is unlikely to lead to major political earthquakes, but may see one or two new political parties (for example, the Free Party or the Conservative People's Party) entering the legislature. Both parties are right-of-center in terms of their economic and social policies, and hawkish on defense and foreign policy (especially regarding Russia). This is especially the case with the strongly nationalist and traditional Conservative People's Party, while the Free Party stresses party finance reform and more civil society involvement in the policymaking process. However, the two are unlikely to win more than a small representation in parliament.

A much more significant risk is posed by the deepening ostracization of the Centre Party, usually ranked as the second most popular party. Even though its programmatic profile is not necessarily incompatible with those of the other main parties, its long-standing and dominant leader Edgar Savisaar is a highly controversial figure. The party's links to Russian official circles (it maintains a cooperation agreement with Vladimir Putin's United Russia party) as well as its autocratic, clientelistic and corrupt rule in Tallinn have made Savisaar a pariah in national politics. Challenges to his leadership, which would have made the party significantly more amenable to coalition-making, have been launched in recent years by prominent party members, but they have all failed because of Savisaar's grip on the party. In March 2015, Savisaar fell ill with a severe bacterial infection that eventually led to part of his leg being amputated and the need for months of recovery. Deputy chair Kadri Simson took over leadership of the party while other officials replaced Savisaar in the Tallinn city government. This dramatic health crisis caused speculation about the future stability of the party, but initially unity was maintained.

Other parties are unlikely to allow Savisaar to form or join a government, even if the Centre Party were to win the biggest number of votes. On the one hand, this kind of deadlock leads to a very limited number of coalition options for the other parties. This could allow new parties to become kingmakers. On the other hand, it is likely to lead to the continued dominance of the Reform Party (which remains the most popular party in public opinion polls). The party has been included in almost all coalitions since it was established in 1995. It has been widely criticized in recent years for being a force of stagnation rather than progress. Because of its very pragmatic outlook and well-funded campaigns, in combination with the strongest political machine of any Estonian party, it has arguably turned into a "party of power."

Besides Savisaar, the main dividing issue between parties has been economic policy – such as whether to continue with Estonia's flat-rate income tax regime and its low level of social expenditures. The differences between the parties are generally modest as none of the major parties

advocates a radical departure from broadly liberal economic policies and balanced budgets. However, the likelihood that a more progressive tax system might be introduced in the future increased in 2014 when the IRL unveiled an election manifesto committed to that effect, leaving the Reform Party as the only parliamentary party defending the flat tax status quo. Even if some form of progressive taxation were to be introduced, it would be unlikely to represent a major departure from previous economic policies. Indeed, membership in the European Union and the European Monetary Union sets significant constraints on policies that can be pursued by the government; all major political players are keen to abide by these European norms.

One of the main economic risks that the country has faced is a high dependence on exports and foreign investments for economic growth. For a small and open economy such as Estonia, external shocks and credit cycles can pose much more significant risks for economic growth than unfavorable domestic political developments. The country weathered the recession reasonably well by adopting a radical austerity program with limited domestic opposition, and aided by a widespread understanding that the crisis was not of the government's making. Post-recession recovery has been much more linked to increased domestic demand, and all major parties have come to acknowledge its beneficial effects to a greater degree than before the recession (even if concrete fiscal and tax policy proposals differ).

Labor migration to other EU countries – particularly Finland – may pose further challenges. During the recession, migration acted as a safety valve against rising unemployment, and those working abroad have injected money into the Estonian economy. After the recession, as unemployment decreased considerably, the problem of skills shortages and the danger of permanent brain drain have come to the fore. Still, Finland is close enough to allow migrants to retain very close ties or even commute. As a result, the potential for permanent migration is arguably lower than, for example, in Lithuania or Latvia.

Finally, the conflict in Ukraine has raised new medium- and long-term risks. In 2014, Estonia received assurances about NATO's security guarantees from Western leaders as well as increased air defense patrols and semi-permanent U.S. troop placements in the country. The risk of an imminent armed conflict with Russia was very low, but increased regional and global tensions could lead to future challenges. The international situation could decrease the attractiveness of Estonia for foreign investors, which would then negatively affect export markets and ultimately make interethnic relations in Estonia more difficult.