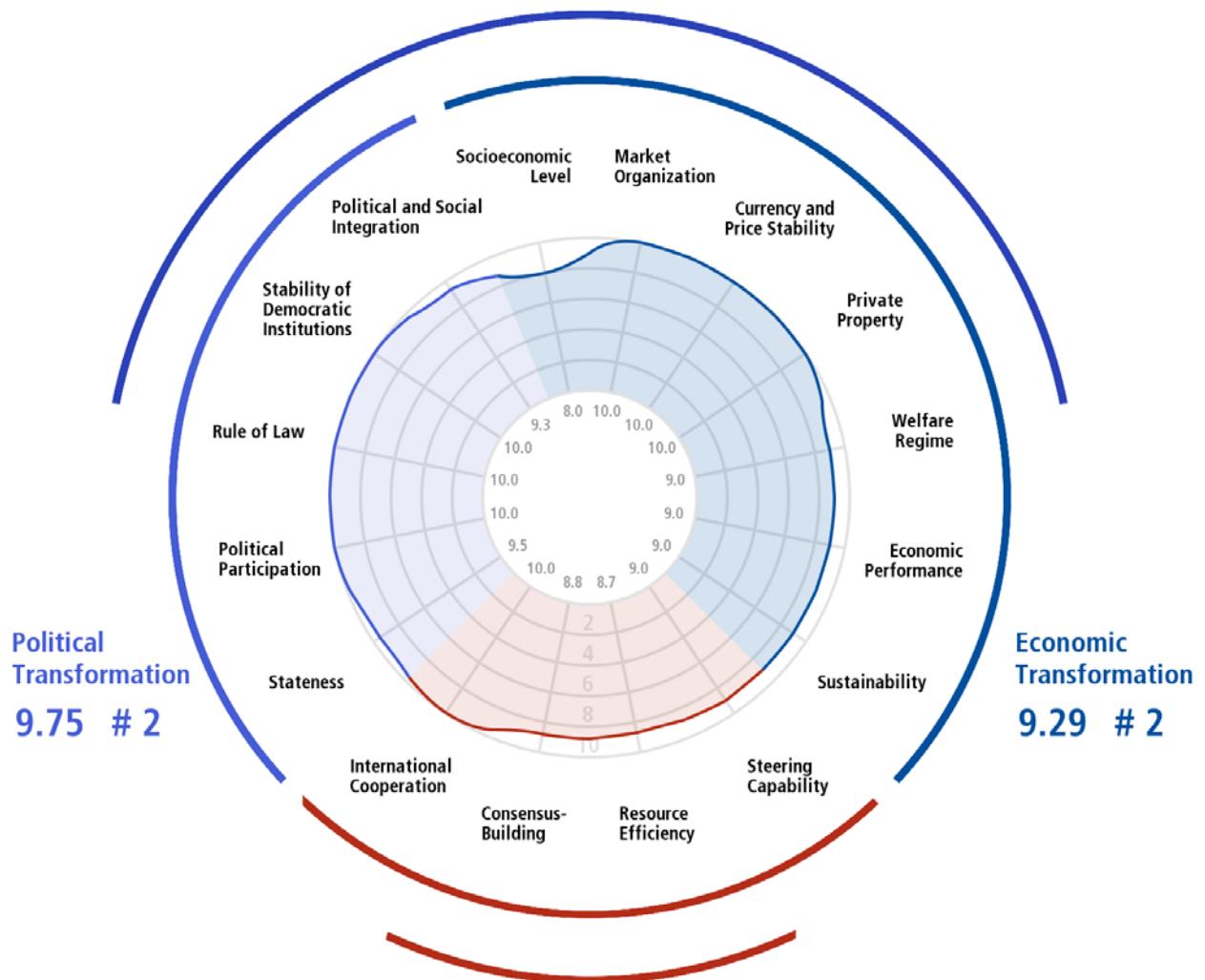


Estonia

Status Index

9.52 # 1

on 1-10 scale out of 129



Political Transformation
9.75 # 2

Economic Transformation
9.29 # 2

Governance Index

7.44 # 1

on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. 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	0.865	GDP p.c., PPP \$	29365
Pop. growth ¹	% p.a.	0.1	HDI rank of 188	30	Gini Index	34.6
Life expectancy	years	77.1	UN Education Index	0.899	Poverty ³	% 1.2
Urban population	%	67.5	Gender inequality ²	0.131	Aid per capita	\$ -

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

Estonia has largely recovered from the economic recession of 2008 and 2009. This recovery was aided by the innovativeness and efficiency of both the public and private sectors. Foreign investors have remained attracted to Estonia due to its openness, streamlined government, strong rule of law and business-friendly environment. Economic output has increased despite sluggish growth in the European Union. The government's financial position continues to be favorable, thanks to the lowest public debt in the European Union. Yet, there are challenges linked to its small size and the openness of its economy. Economic growth is dependent on the inflow of foreign investment and external demand, both of which have been weak since the recession. Continued economic stagnation and political turbulence in the European Union and beyond as well as an increasingly aggressive Russia remain substantial risks.

The Estonia political system has remained stable over the last decade. The Reform Party (RE), which has dominated Estonian coalition governments since 2004, was returned to power in the 2007, 2011 and 2015 parliamentary elections, its popularity largely unaffected by a radical austerity program implemented during the recession. In March 2014, thirty-four-year-old Taavi Rõivas took over the prime ministership after Andrus Ansip, the longest-serving prime minister in the EU, stepped down to become a member of the European Commission. Following the 2015 election, the governing coalition was expanded to include the Social Democratic Party (SDE, RE's previous coalition partner) and Pro Patria and Res Publica Union (IRL). This broader coalition was necessary due to increased party system fractionalization as the number of parliamentary parties increased from four to six. Two new political parties – the center-right Free Party (EVE) and radical-right Conservative People's Party (EKRE) – won, respectively, eight and seven seats in the 101-member parliament.

In November 2016, Edgar Savisaar, the longstanding and highly controversial leader of the main opposition party (Center Party, KE), was replaced by his former protégé turned challenger Jüri Ratas. In 2015, Savisaar had suffered both from a serious health crisis – he was in a coma and a

leg was amputated – and corruption allegations that saw him suspended as the mayor of Tallinn (Estonia’s capital and largest city). The leadership change immediately rendered KE attractive as a coalition partner and Ratas was sworn in as prime minister shortly thereafter, leading a cabinet that includes SDE and IRL. This change of government marked the end of RE’s political dominance in Estonian politics as it entered the opposition for the first time in 17 years. One factor contributing to the downfall of RE was its inability to agree upon a joint candidate in the 2016 presidential elections. Competition between two candidates backed by the party led to a failure to elect a president in the parliament and, later, in a specially convened electoral college. Eventually, the elections returned to the parliament which, with an overwhelming majority, elected the non-partisan Kersti Kaljulaid (a former member of the European Court of Auditors) the first female president of Estonia. Even so, neither the new prime minister nor president have heralded any significant change in the political direction of the country.

Since 2012, there have been signs that civil society is becoming more politically active. There has been an increase in national strikes 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. However, mobilization for democratic reforms has since decreased because of the inadequate progress made in implementing the proposals. In 2014, supporters as well as opponents of a draft bill on civil partnerships for same-sex couples took to the streets and social media. The parliament eventually passed the bill, making Estonia the first country formerly part of the Soviet Union to legalize same-sex partnerships. However, additional acts necessary for the legislation’s full implementation have not been passed by the parliament elected in 2015 due to changes in the governing coalition. 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, interest groups focus on lobbying the president to veto legislation, due to a perception that the government – and by extension, the parliament – is not engaged in genuine consultations with civil society.

Interethnic relations between the ethnic Estonian majority and Russian-speaking minority have not significantly improved over the last decade. The ethnic cleavage is not wholly politicized as the minority has chiefly been represented by the cross-ethnic KE. In recent years, it has voiced opposition to education reforms that substantially increased the compulsory use of Estonian in Russian-language schools. Rising tensions between Estonia and Russia since 2014 – over Russia’s annexation of Ukraine and assertive foreign policy – have put additional strains on interethnic relations as public attitudes on Putin’s regime, the conflict in Ukraine, and potential Russian threats are divided.

History and Characteristics of Transformation

The roots of the Estonian transition lie in the reforms initiated by Mikhail Gorbachev in the mid-1980s. These led to increased openness as well as 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 rift soon opened between radical pro-independence forces (e.g., the National Independence Party, established in 1988) and moderate popular movements (e.g., the Popular Front). The last Estonian Supreme Soviet, elected in free elections in 1990, was dominated by moderate lawmakers. 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 the Constitutional Assembly that drafted the constitution passed in a 1992 referendum. The divide between the two pro-independence political streams can still be observed 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 a source of disagreement between the two factions. The moderates and radicals shared suspicions about the loyalty of the settlers, but the former were keener to reach out and integrate the Russian-speakers. Following independence, the radicals' policies dominated the formation of regulations on citizenship and language.

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 – could only obtain citizenship through naturalization. Many instead chose to become citizens of the Russian Federation (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 10% of the population are citizens of a foreign country (mostly the Russian Federation) and 6% remain stateless. The ethnic divide failed to develop into a full-blown political cleavage, partly because of the limited franchise of Russian-speakers.

As support for the *ancien régime* was low among citizens, the government managed to push through radical economic reforms and completely reorientate the country both in its foreign relations and trade patterns. Since the early 1990s, Estonia has firmly pursued integration with NATO, the European Union (EU) and other Western institutions (e.g., IMF, WTO, and OECD). The accessions to NATO and the EU enjoyed strong consensus among elites and determination to conform to the membership criteria. In contrast, Euroscepticism among the general population was high compared to most other new member states in Central and Eastern Europe. Eurosceptic sentiments were shared by the less well-off, who endured further increases to their cost of living,

hardline nationalists, who disputed the sharing of sovereignty, and 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 liberal market 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 on average by 7.1% a year without interruption from 1995 until the Great Recession in 2008. Economic growth returned in 2010 and has remained positive despite economic troubles in the EU. Estonia 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 Economic and Monetary Union (in 2011).

Government and party system stability were generally low in the 1990s and early 2000s. Parties that had formed shortly before parliamentary elections witnessed remarkable success in 1995 (i.e., Reform Party) and 2003 (i.e., Res Publica), and a leading party in several governments in the 1990s (i.e., Koonderakond) disbanded itself in 2000. However, the policies of various governments have been remarkably consistent and the party system has become more stable. Even so, two new political parties, including the radical-right Conservative People's Party, won 15% of the seats in the 2015 parliamentary election.

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

The state has a monopoly on the use of force across its territory. Currently, there are no extra-legal forces or immediate threats to territorial integrity. In the early 1990s, there was a short-lived and localized risk that Ida-Virumaa (the northeastern region inhabited mostly by Russian-speakers) might secede to 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 police officer was abducted by Russian security services on the Estonian side of the border and only returned one year later in exchange for a Russian spy. As a response to the heightened risk of future Russian military incursions, a NATO battalion lead by the British Army was deployed to Estonia in 2016. However, U.S. President Donald Trump's isolationist and pro-Putin views have raised concerns about the future of NATO's principle of collective defense.

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 and 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 (the groups constitute about 10% and 6% of the population, respectively). 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. 884 persons acquired citizenship by naturalization in 2015, a significant decline compared to previous years. Changes to the citizenship law in 2015 relaxed conditions for naturalization as automatic citizenship was granted to newborn children of non-citizens and simplified language tests were introduced for elderly applicants.

Question
Score

Monopoly on the
use of force

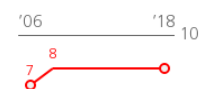
10



1

State identity

8



1

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. In 2016, the newly elected president, Kersti Kaljulaid, turned down an offer from the Estonian Lutheran Church to hold the traditional inaugural service. This was viewed as a further sign of secularism in Estonia.

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. A crucial element of Estonia's administrative capacity is the wide array of e-government services. These have made administrative tasks more efficient and less prone to corruption.

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 2015 parliamentary elections, 15 complaints were submitted to the Supreme Court (which resolves electoral complaints), all of which were rejected. Polling is highly accessible as early voting periods are long and advanced online voting has been used since 2005 (three times 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 one-third of votes were cast online in the 2015 parliamentary 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.

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 tend to be 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

No interference of religious dogmas

10



1

Basic

administration

10



1

Free and fair elections

10



1

campaigning. These have primarily targeted the Center Party following the 2013 local elections in Tallinn, but also Prime Minister Rõivas, who shot a campaign clip at a military airbase before the 2015 parliamentary elections. A special party financing oversight commission has reviewed these allegations and in many cases forced politicians or parties to pay back these government funds, in one case totaling more than €100,000.

In Estonia, democratically elected power holders have 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 particular sectors 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.

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. Non-citizens may not join political parties. 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.

Freedom of expression is enshrined in the constitution and unrestricted in practice. In 2016, Estonia ranked 14th 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 many 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.

The media – especially the popular public broadcaster – is generally unbiased and represents a wide spectrum of opinions. The Public Broadcasting Council is composed of six 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 owned by a local media group Estonian Media and the Swedish Modern Times Group. 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 2015).

Effective power to govern

10



Association / assembly rights

10



Freedom of expression

10



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.

The lack of Russian-language public media to cater to the Russian-speaking minority has recently been a major concern. There are some Russian-language newspapers and the public broadcaster runs a Russian-language radio channel. However, channels operating from or controlled by the Russian Federation have been dominant, leaving the minority population exposed to misinformation and propaganda. These concerns intensified in the wake of the Russian-Ukrainian conflict, and in 2014 the Estonian government approved the establishment of a public Russian-language television broadcaster. However, the channel, which launched in 2015, has struggled in terms of viewership compared to established Russian-language outlets.

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 pressure. Due to the parliamentary political system, the executive and legislative powers are fused, with the former generally dominating over the latter. However, the coalition of three parties that came to power following the 2015 parliamentary elections suffered from constant infighting and was terminated following a successful parliamentary vote of no confidence in November 2017. Parliamentary committees are entitled to request information and responses to questions, and have pressed the government to provide documents or send ministers to parliamentary hearings. The task areas of committees generally coincide with the portfolios of ministries, supporting effective parliamentary oversight. In recent years, the Parliamentary Anti-Corruption Committee has held many hearings into prominent cases of alleged corruption. In 2015, a special investigative committee on alleged corruption in the (state-owned) Port of Tallinn was established.

The Estonian courts are independent and free both from executive intervention and, by and large, from corruption; where corruption issues have been revealed, judges have been investigated and removed by the designated authorities. 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 performs 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

Separation of powers

10



1

Independent judiciary

10



1

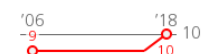
monitors the implementation of its rulings by the parliament. For example, in 2015 the Supreme Court declared eight out of 28 reviewed non-electoral legal acts wholly or partially unconstitutional.

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 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%). According to the 2016 Global Corruption Barometer, corruption is seen as one of the three most important problems facing the country by only 25% of Estonian respondents and levels of bribery are one of the lowest in Central and Eastern Europe. However, several high-profile cases have been brought to the courts in recent years. In 2014, two former government ministers were found guilty and received a custodial sentence in a case concerning land swaps carried out during the 2000s. Recent high-profile corruption cases include charges against the former Mayor of Tallinn Edgar Savisaar (for taking kickbacks) and former board members of the state-owned Port of Tallinn (for corrupt tendering procedures). Prosecutions related to these charges have taken more than a year.

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 (CoJ) monitors the protection of fundamental rights and freedoms, and performs the function of ombudsman, including with regard to children's rights; this is in addition to the CoJ's role in constitutional reviews. 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 (currently held by women) have generally maintained independence from the government and been effective. 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, but there is currently little systematic evidence of that. Instead, among the ethnic minority population, a marked increase in the number of ethnic Estonian friends, acquaintances and colleagues was reported in the 2015 Estonian Integration Monitoring survey compared to 2010. According to a U.S. State Department report, Estonian police in 2015 registered six cases of physical abuse which included hatred against racial/ethnic minorities. Two of these cases led to court rulings convicting the perpetrators.

Prosecution of
office abuse

10



1

Civil rights

10



1

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 Center Party) occasionally surface, but never to the detriment of democratic governance. An important breakthrough in governance that was achieved in 2016 was movement toward large-scale local government reform, consolidating the number of municipalities from over 200 to around 100.

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 Center Party has repeatedly, but unsuccessfully, challenged the legitimacy of internet voting.

Performance of democratic institutions



Commitment to democratic institutions

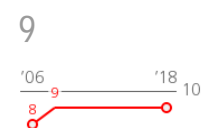


5 | Political and Social Integration

The main political parties have developed strong organizations, including efficient central offices and local branches. The 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 a previous merger in 2006. For a long time, the Center Party has repeatedly suffered 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.

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. No new parties entered the parliament in the 2007 and 2011 parliamentary elections. In 2015, two new parties – the center-right Free Party and the radical-right Conservative People's Party – entered the parliament with 8% and 7% of the seats, respectively. Although this increased electoral volatility compared to the previous two national elections, the absolute level of volatility continues to be

Party system



relatively low. The party system has been fairly polarized, mostly because under its longstanding controversial leader Edgar Savisaar, the Center Party (the main opposition party since 2003) was excluded from forming coalitions with other parties. This changed at the end of the 2016 when Jüri Ratas replaced Savisaar as the party's leader and very quickly put together a new governing coalition that sent the Reform Party (previously dominant in coalition politics) to the opposition benches. The long-term effect of this major shift remains to be seen.

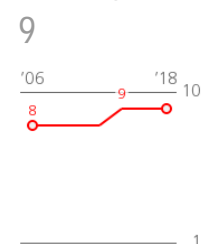
Even though freedom of organization is granted by the constitution, the system of interest representation and mediation has been weak. On one hand, the number of active NGOs is low. On the other hand, those that do attempt to influence the political process have limited sway. The Estonian Trade Union Confederation is comprised of 18 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 policy-making process initiated by the government. The Estonian Employers' Union has been more active 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. Significant examples include mobilization by groups for and against legal recognition of same-sex couples in 2014. 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 for a vetoing of laws passed by what they see as an unresponsive parliament.

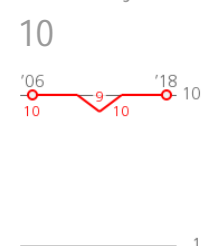
In Estonia, support for democratic norms and democratic political institutions is fairly high, but it lags behind levels that exist in countries with a longer experience of democracy. Popular satisfaction with the way democracy works in Estonia is close to the EU average. According to a 2016 Eurobarometer survey, the level of satisfaction with the workings of democracy at the national level in Estonia (51%) was roughly equal to the EU average (48%) and one of the highest among the Central and East European member states. Trust in national institutions in 2016 was among the highest in Central and East Europe. Estonians trust national and local government as well as parliament (at 43%, 53% and 33%, respectively) significantly more than the EU average (27%, 46% and 28%). Trust in political parties is low, but close to the EU average (respectively, 14% and 15%).

According to the 2012 European Social Survey, 85% of Estonian respondents 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

Interest groups



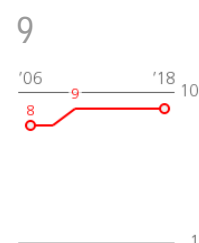
Approval of democracy



of trust in the legal system and police are above levels in all other post-communist countries and many South European countries.

Levels of interpersonal trust in Estonia are high compared to other post-communist countries and many Western European countries. According to the 2015 European Social Survey, 36% of Estonian respondents 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 23% in the six post-communist countries included in the survey. Levels of volunteering were low by Western European standards and average by Central and East European standards: in 2012, three-quarters of respondents said that they had not volunteered in the last 12 months.

Social capital



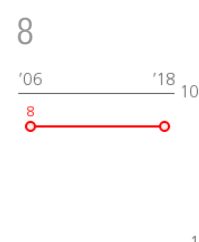
II. Economic Transformation

6 | Level of Socioeconomic Development

Estonia has reached a very high level of human development according to United Nations' Human Development Index. It ranks 30th 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 (34.8 versus 31.0 in 2015), 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 (1.6% of the population were living on less than \$3.10 a day PPP in 2012). Relative poverty – measured as the share of population on incomes below 60% of the national median – at 21.0% was below the EU average and among the lowest in Central and Eastern Europe in 2014. Relative poverty was some six percentage points higher among ethnic minorities than ethnic Estonians and particularly high in northeastern Estonia (30%), predominantly inhabited by Russian speakers.

Question
Score

Socioeconomic
barriers



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 gender pay gap in the European Union (28% compared to the EU average of 16.7% in 2014, according to Eurostat).

Enrollment levels of both girls and boys in primary and secondary education are very good, and tertiary education attainment is better than the EU average (45.3% versus 38.7% among 30 – 34-year-olds in 2015). Notably, Estonia has one of the highest shares of female university students across the European Union (59.2% in 2012).

Economic indicators		2013	2014	2015	2016
GDP	\$ M	25081.2	26213.9	22460.5	23136.7
GDP growth	%	1.4	2.8	1.4	1.6
Inflation (CPI)	%	2.8	-0.1	-0.5	0.1
Unemployment	%	8.6	7.4	6.2	6.9
Foreign direct investment	% of GDP	4.3	6.4	-2.9	3.1
Export growth	%	2.3	3.1	-0.6	3.6
Import growth	%	3.2	2.2	-1.4	4.9
Current account balance	\$ M	-86.1	225.5	493.1	616.9
Public debt	% of GDP	10.2	10.7	10.0	9.4
External debt	\$ M	-	-	-	-
Total debt service	\$ M	-	-	-	-
Net lending/borrowing	% of GDP	0.0	0.0	0.0	-
Tax revenue	% of GDP	1.3	1.3	1.4	-
Government consumption	% of GDP	18.9	19.3	20.3	20.6
Public education spending	% of GDP	4.8	5.5	-	-
Public health spending	% of GDP	5.1	5.0	-	-
R&D expenditure	% of GDP	1.7	1.5	1.5	-
Military expenditure	% of GDP	1.9	2.0	2.1	2.2

Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

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 (34% versus 40% in 2015). 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, three procedures and three and a half days, and the average costs of registration are 1.2% of Estonia's per-capita income. Prices are fully liberalized. Estonia fully complies

Market-based
competition
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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, the size of the informal economy in Estonia decreased from 20% of GDP in 2009 to 15% (2015). Undeclared business revenues and wages are mainly earned in the construction sector.

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 audits on energy, pharmacies and central heating, among others. According to a 2017 report by the European Commission, the liberalization of Estonia's electricity and gas markets and construction of new energy infrastructure (Estlink 2) have substantially improved competition in Estonia's energy market.

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 combined volume of exports and imports exceeded 154% of the country's GDP in 2015 (World Bank). Non-tariff barriers are largely removed within the internal market and are aligned with those used by the EU in relation to third countries.

Estonia has implemented most of the European Union's banking and finance regulations. Its 11% capital-to-assets ratio is higher than the Basel III minimum requirement (8%). The banking sector is competitive, and dominated by foreign-owned banks. The main banks are subsidiaries of Swedish (Swedbank with 40% market share and SEB with 22%), Finnish (Nordea with 15%) and Danish (Danske Bank with 8%) 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 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% and 5.6%, respectively). Total household debt is high at 82% of gross disposable income, following a sharp increase before the economic recession (OECD).



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Anti-monopoly policy

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Liberalization of foreign trade

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Banking system

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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 modest price increases (2.8% in 2013) and consumer price deflation in 2014 and 2015. The kroon, the national currency from 1992 until the adoption of the euro, 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.

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: 9.7% of GDP in 2015, compared to the EU average of 87.7%. Estonian governments have pursued conservative fiscal policies. State budgets have generally been balanced and often in surplus. During the last financial crisis, the budget went into deficit (-3% of GDP in 2008), but has since returned to balance. Since 2014, a state budget law obliges the government to prepare structurally balanced budgets and established 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 and has remained close to parity since.

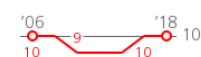
9 | Private Property

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. Registration of property is prompt (18 days) and requires only three procedures (World Bank Doing Business 2017).

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 reacquired by the government in 2010 and ceased operation in 2015 after the European Commission determined the carrier had received

Anti-inflation /
forex policy

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Macrostability

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Property rights

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Private enterprise

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state subsidies illegally; it was replaced by a new state-owned carrier (Nordica). 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.



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% (32.5% since 2017) 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 (most adults who are out of work but not in receipt of a pension or social benefits, amounting to 6.5% of the population). Total public spending on health (5% of GDP) is much lower than the EU average (7.8%), but comparable to most Central and East European member states.

Social safety nets

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The pension system is based on three pillars: (1) state pensions, (2) mandatory funded pensions invested in private pension funds and (3) private supplementary pensions supported by tax incentives. The second pillar was established in 2002 to ease the future budgetary burden resulting from the aging population. Compulsory payments into this system were suspended during the recession, but were resumed gradually in 2011 and 2012.

Parental leave benefits and unemployment insurance outlays are relatively generous. The parental leave benefit amounts to 100% of a person's prior salary and is paid up to 19 months (including pre-natal leave). The 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%, but was later reduced and has been 2.4% since 2015 (paid partly by the employer and partly by the employee).

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 €400 in 2016, with some increases planned for 2017. 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. Since 2015, monthly child benefits are incrementally increasing from €45 to €60 in 2019 as well as rising to €200 in 2017 for three or more children.

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 significantly outnumber men among university students. Estonia also boasts the highest female employment level in Central and Eastern Europe (68.5% in contrast to the EU average of 60.4% in 2015), albeit controversially accompanied by the highest gender pay gap in the European Union (28.1%, while the EU average was 16.7% in 2014).

Equal opportunity



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 Center 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 23.9% among ethnic Russians and at 13.3% among ethnic Estonians. While the gap decreased, it remained above three percentage points in 2015.

The previous parliament formally legalized same-sex partnerships in 2014 by reaching a narrow majority following heated debates. Provisions implementing this decision, however, have not yet been passed by the current parliament (elected in 2015), whose majority is against the law, partly due to the staunch opposition of the radical-right Conservative People's Party.

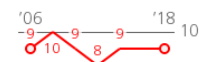
11 | Economic Performance

Following a robust recovery in 2011 and 2012 from the deep recession, economic growth stalled between in 2013 and 2015. At 1.9% on average, it was slightly higher than the overall GDP growth in the EU (1.3%), but significantly slower than that of its southern neighbors Latvia and Lithuania (both about 2.6%).

Output strength

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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 the country has occasionally experienced deflation (most recently in 2014 and 2015). Unemployment increased considerably during the recession, when Estonia saw some of the European Union's highest levels of joblessness (16.9% in 2009). By 2014, this figure was back down to 7.7%, below the EU average of 10.2%.



In contrast to the pre-recession years, economic growth has recently been less related to the inflow of foreign capital than to increasing domestic and external demand. FDI peaked in 2007 at 15.4% of GDP, and though it picked up after the recession, FDI inflows have remained more moderate.

12 | Sustainability

Estonia's environmental performance has improved in recent years according to the Environmental Performance Index. In 2016, it was ranked 8th in the world and has experienced positive trends over the last decade on nearly all indicators.

Environmental
policy

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The country scores very highly for fertilizer efficiency, biodiversity, and habitat protection (top performer worldwide) and highly for health impacts, air quality, and wastewater treatment. 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. The Ministry of Environment articulated a vision of an integrated system of environmental protection that covers the entire country and ensures the preservation of a clean environment and sustainable use of natural resources. 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, the promotion of public transport (including alternative fuels and electric transport), electric cars for social workers and investments in wind energy. In 2012, 25% of energy consumed in Estonia came from renewable sources.



Estonia has invested significantly in renovating and expanding its water management infrastructure. While water pollution has decreased and the quality of tap water has improved, an estimated 26% of surface water continues to be polluted. One of the main risks for biodiversity is increasing traffic and road construction, though the newest roads have been constructed in accordance with environmental protection regulations. For example, the first "ecoduct" (i.e., wildlife crossings) has been opened on the main national highway between Tallinn and Tartu.

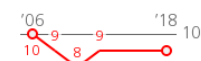
Education enrollment levels and the general quality of education are high in Estonia. In the 2015 PISA, the country scored 3rd highest globally in science and was among the top 10 in both reading and mathematics. The level of public spending on education is close to the EU average and among the highest in Central and Eastern Europe (4.7% of GDP in 2012). Expenditures on R&D more than doubled between 2003 and 2012 (from 0.8% to 2.2% of GDP), but declined quickly to 1.4% by 2014. The level is still above the Central and East European average, but lags behind mean R&D expenditures in the EU. 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. Estonia has also established a system of e-residency by issuing 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.

Over the years, Estonian governments have been committed to supporting innovation and education, although extra funding has not always been forthcoming. Following a general teachers' strike in 2012, teachers' salaries were significantly increased, with further increases planned for 2017. 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 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 have been closed in recent years while universities have sought to consolidate faculties, degree programs and research teams.

Education policy /
R&D

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Governance

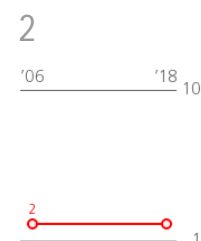
I. Level of Difficulty

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 have adversely affected some sectors of the economy, primarily the agriculture and food industries (due to a Russian embargo on EU food products) and tourism (Estonia had been a popular destination among Russian tourists). However, the share of foreign trade with Russia was quite limited (6% of exports, down by 55% in total value since 2012).

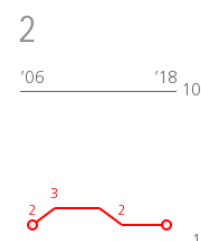
Estonian civil society may be weak when compared to its Nordic neighbors, but it is better developed than in most other former communist countries. For example, Estonia boasts the highest level of interpersonal trust in Central and Eastern Europe. Various civil society organizations (CSOs) participate 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 early 2015, a new Civil Society Development Concept was approved by the government. In 2016, the newly elected president, Kersti Kaljulaid, appointed a special advisor on civil society affairs.

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

Structural
constraints



Civil society
traditions



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 Center 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. Prominent Russian-speaking Center 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. However, following a leadership change at the end of 2016, Jüri Ratas, the newly elected leader of the party, became the prime minister at the helm of a coalition of three parties. The long-term implications of the new coalition on conflict intensity remain to be seen. While it could ameliorate ethnic divides, it could also lead to the rise of a new, more radical Russian-speaking party based on defections from the Center Party or organizations promoting Russian-speakers' interests.

Conflict intensity

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II. Governance 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. 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 2014 to be nominated for a post in the European Commission, he

Question

Score

Prioritization

9

had been in office for nine years and had become the longest-serving prime minister in Europe. His successor, Taavi Rõivas, presided over two coalitions characterized by increased infighting and “fine-tuning” of policies rather than determined pursuit of priorities and ambitious plans. The Reform Party was resigned to the opposition (after being in government continuously for 17 years) when the Center Party formed a new coalition with the Reform Party’s previous coalition partners.

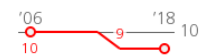
All governing coalitions have subscribed to key policy priorities such as a prudent fiscal policy and knowledge-based economy. The Ratas government adopted an action program structured into four core objectives (increasing population, social welfare and integration, promotion of economic development, and strengthening of national security) and 11 areas covering more than 150 objectives; the program is supplemented with detailed targets and deadlines.

A new portfolio of administrative reforms was introduced after the 2015 elections. Some progress has since been made on important reforms, including local government restructuring (to merge numerous poor and tiny local councils). The new Center Party-led coalition has been very active on local government reforms, setting up a dedicated parliamentary committee and announcing the abolition of county governments (unified regional government agencies) from 2018.

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, 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. Following the 2015 parliamentary elections, the three parties joined a coalition marred by infighting from the beginning which led to the creation of a new Center Party-led coalition in late 2016. Thus, no cabinet has survived a full four-year term in office. Nevertheless, all governments have been able to balance the state budget – a hallmark policy of all center-right coalitions that has remained unchallenged by the unusually left-leaning Ratas government.

In 2016, the previous coalition introduced the Administrative Reform Act which envisaged the voluntary merger of municipalities to ensure the provision and accessibility of high-quality social services. As a consequence, the number of municipalities decreased from 213 to 100.

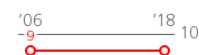
As a member state of the European Union and OECD, Estonia is thoroughly integrated into international networks of policy exchange. Hence, policymakers are continually exposed to new and different ideas. The volatile economic conditions from 2008 to 2011 demanded a particularly high degree of policy flexibility. Regulatory impact assessment procedures are well-established, cover an increasing



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Implementation

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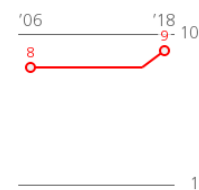


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Policy learning

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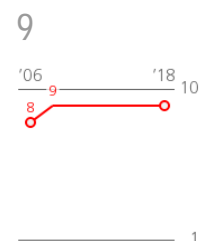
number of legal acts and require the involvement of relevant interest groups and public consultations in the lawmaking process. There is a strategy unit at the Government Office, but it has limited capacity and impact. The government relies on external academic advice, but the extent to which scholarly findings and recommendations influence policy proposals varies greatly. Since March 2014, the Act on National Government allows the flexible nomination of ministers based on current needs; it no longer lists ministers, but rather only sets a maximum number for the government as a whole. 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.



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 have recently been 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

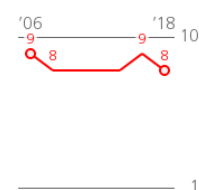


The National Audit Office is an independent constitutional institution that monitors the use of budgetary resources by the state and local governments through both financial and performance audits. It has provided rigorous critique of administrative practices, the failure of state innovation funds to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

A Strategy Unit in the Government Office supports policy planning and coordinates the implementation of the government's action plan as well as strategic development plans. However, the high number strategic documents (49) may hinder effective coordination.

Policy coordination

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Governments have generally been united behind the policies proposed in coalition agreements. There has been limited public friction about policies, not least because of the small size of the country, which makes it easier to iron out disagreements in private. However, the coalition of the Reform Party, the Social Democrats and Pro Patria and Res Publica Union that entered office after the 2015 elections suffered

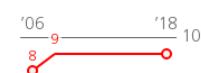
from unusually poor policy coordination from its inception. Ministers representing the different parties often announced policy proposals or ideas without consulting their coalition partners who then often publicly disagreed. The new coalition formed at the end of 2016 appeared to have a smoother start and adopted a detailed plan of work outlined. The Estonian presidency of the Council of the European Union in the second half of 2017 will be a significant test of the government's coordination capacity.

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, but the GRECO Compliance Report from March 2015 still pointed out a number of issues, particularly with regard to MPs declaration of interests and assets.

The regulation of party financing has been a particularly controversial issue in recent years. The leader of the opposition Center Party, Edgar Savisaar (until November 2016), 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. In 2015, Savisaar was suspended from the mayor's office by a court as he was the subject of bribery investigation. Among the other main parties, the Reform Party has also faced accusations of receiving anonymous donations and being linked to alleged corruption at the (state-owned) Port of Tallinn. 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 reports were submitted to a committee composed exclusively 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, particularly since 2015 as there are six parties represented in the parliament.

Anti-corruption
policy

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16 | Consensus-Building

Representative democracy is uniformly accepted by all relevant political actors.

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 the government (the Center Party and Social Democratic Party), agree with these fundamental objectives in broad terms.

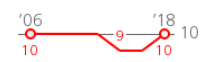
There are no anti-democratic political, military or economic actors with any significant voice or power in Estonia.

The main social cleavage is between the ethnic Estonian majority (69% of population) and a sizable Russian-speaking minority (25%). The communities often live separate lives and are divided by latent issues such as the interpretation of the Soviet occupation, Putin's regime and Russian actions in Ukraine. However, the cleavage is only partially politicized, as ethnic Russian parties have been weak and unrepresented in the national parliament since 2003. Ethnic Russians have been mostly represented by the Center 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, Jevgeni Osinovski (SDE) was sworn in as the first ethnic Russian minister not representing the Center Party; he became the leader of his party in 2015. In November 2015, following longstanding internal strife, Jüri Ratas was elected the leader of the Center Party, replacing Edgar Savisaar. This was partly seen as a defeat for the pro-Russian wing of the party as most of the leading ethnic Russian members were close to Savisaar. While the party has remained intact, the leadership change raises the possibility of an ethnically based split.

The political leadership actively enables civil society participation. 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

Consensus on goals

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Anti-democratic actors

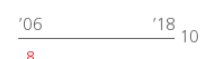
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Cleavage / conflict management

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Civil society participation

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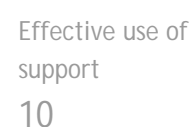
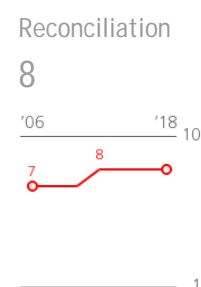
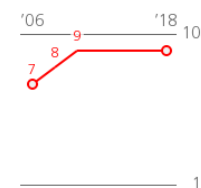
prominent public intellectuals issued a document entitled Charter 12, calling for the strengthening of democracy in response to a party-funding scandal surrounding the governing Reform Party. A People's Assembly, or online platform for crowd-sourcing reform proposals, was set up after Estonia's president convened a national political roundtable. In 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.

To promote participation in civic organizations, the government has created a National Foundation for Civil Society, which regularly awards grants to NGOs. Civil society actors have become increasingly active in politics. In recent years, 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 the Anti-Counterfeiting Trade Agreement (ACTA).

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 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. However, the past is often addressed in an understated manner in Estonia. For example, it was decided in 2016 that the Museum of Occupations in Tallinn would be renamed the Vabamu (roughly, the Museum of Freedom).

17 | International Cooperation

Estonia has benefited from generous assistance from the EU's Structural Funds. More than 2% of the country's GDP was allocated for both the 2007 to 2013 and 2014 to 2020 financial periods (the ratio to GDP is decreasing due to economic growth). Prioritized activity fields include accessible education, employment, quality of work life, knowledge-intensive economy, efficient use of resources, environment and



sustainable infrastructure. 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. However, Estonia does not have any clear strategy of how to maintain some of its new investments once EU funding trickles off after 2020.

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. 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.

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.

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. A floating terminal has been opened in Lithuania that could, in principle, cover most of the natural gas needs of the Baltic states. Also, in October 2016, a construction agreement was signed on Balticconnector (an undersea natural gas pipeline to 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 increased tensions between Russia and the West since the start of the conflict in Ukraine in 2014. There has been renewed optimism concerning the border treaty after it was



Credibility

10



Regional

cooperation

10



signed again in 2014 (Russia had withdrawn its signature in 2005). The treaty was sent to the parliaments of both countries for ratification in late 2015, but remains unratified at the time of writing.

Strategic Outlook

Estonia faces few critical challenges in the short- and medium-term. Widespread approval of democratic principles and only modest support for anti-establishment or radical parties make political instability unlikely. The 2015 parliamentary election saw the entry into the legislature of two new political parties (the Free Party and Conservative People's Party). Both parties are right-of-center in terms of their economic and social policies as well as hawkish on defense and foreign policy (especially regarding Russia). While the Conservative People's Party is strongly nationalistic and traditional, the Free Party stresses party finance reform and increased civil society involvement in the policy-making process. The two parties have a fairly small representation in parliament; there are no signs of widespread radicalization of the electorate. However, the increased fragmentation of the party system has made it more difficult to build coalitions with a solid parliamentary majority and strong spirit of cooperation. At the same time, the leadership change in the Center Party that transformed the longstanding pariah in Estonian politics into an attractive coalition partner, multiplied the number of potentially feasible governing coalitions.

Fallout between the Center Party's old and new leadership could potentially lead to further changes in the Estonian party system. Edgar Savisaar, the party's previous leader has been a longstanding highly controversial figure in Estonian politics. The party's links to official Russian political circles (it maintains a cooperation agreement with Vladimir Putin's United Russia party) as well as Savisaar's autocratic, clientelistic and corrupt rule as mayor of Tallinn made him a pariah in national politics. That, as well as his removal as mayor by a court order following corruption allegations and serious health issues, waned support for Savisaar among party members and erstwhile loyalists in leadership circles. While tensions within the party appear to have eased since its entry into government, some arch-loyalists (e.g., Yana Toom, the party's only member of the European Parliament) may run separate lists in the 2017 local elections. Also, if the new leadership is perceived to desert the party's Russian-speaking supporters, a significant niche could open for a new, potentially more pro-Kremlin, party.

The main economic issues have included the continued support for Estonia's flat-rate income tax regime and the 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, since 2014, the Reform Party has been the only main party tenaciously defending the flat tax status quo. The new Center Party-led coalition tweaked personal income tax allowances, but this amounted to only a modest departure from previous policies. In addition to the general commitment of government coalition members to market liberalism, Estonia's memberships in the EU and European Economic and Monetary Union set significant constraints on the policies that can be pursued by the government; all major political players are keen to abide by European norms.

One of the main economic risks to the country is its 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 far more significant risks for economic growth than unfavorable domestic political developments. The country weathered the Great Recession reasonably well by adopting a radical austerity program, aided by limited domestic opposition and a widespread understanding that the crisis was not of the government's making. The post-recession recovery has been linked to increased domestic demand, with all major parties acknowledging 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 challenges. During the recession, migration acted as a safety valve against rising unemployment and those working abroad injected money into the Estonian economy. After the recession, as unemployment plummeted, skills shortages and the danger of a 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 lower than, for example, in Lithuania or Latvia.

Finally, the continued conflict in Ukraine and Russia's international aggressiveness in general have raised new medium- and long-term risks. In 2016, NATO's security guarantees materialized in the stationing of international battalions in the Baltic member-states (lead by British forces in Estonia), in addition to increased air defense patrols. The risk of an imminent armed conflict with Russia may remain low, but online and media propaganda as well as potential cyberattacks pose considerable risks. Key international developments during 2016 – the election of Donald Trump as president of the United States and Brexit referendum in the United Kingdom – raised uncertainties both about the future effectiveness of NATO and outlook for the European Union. These concerns and their potential implications on the global economy could reduce the attractiveness of Estonia among foreign investors and in export markets. Possible economic repercussions could ultimately affect interethnic relations in Estonia and potentially increase Russia's power in the battle over the hearts and minds of the Russian-speaking minority.