ESTONIA

UNITARY COUNTRY

BASIC SOCIO-ECONOMIC INDICATORS

INCOME GROUP: HIGH INCOME

LOCAL CURRENCY: EURO (EUR)

POPULATION AND GEOGRAPHY

Area: 43 432 km^2
Population: 1.316 million inhabitants (2017), a decrease of -0.3 % per year (2010-2015)
Density: 30 inhabitants / km^2
Urban population: 68.7 % of national population
Urban population growth: 0.2% (2017 vs 2016)
Capital city: Tallinn (33.2% of national population)

ECONOMIC DATA

GDP: 41.8 billion (current PPP international dollars), i.e. 31 739 dollars per inhabitant (2017)
Real GDP growth: 4.9% (2017 vs 2016)
Unemployment rate: 5.8% (2017)
Foreign direct investment, net inflows (FDI): 1 555 (BoP, current USD millions, 2017)
Gross Fixed Capital Formation (GFCF): 23.7% of GDP (2017)
HDI: 0.871 (very high), rank 30 (2017)

MAIN FEATURES OF THE MULTI-LEVEL GOVERNANCE FRAMEWORK

The Republic of Estonia is a parliamentary democratic republic. Its legislative power is composed of a unicameral Parliament (*Riigikogu*), which is composed of 101 members who are directly elected for a four-year term according to the system of proportional representation. The President is elected by the Parliament of Estonia for a five-year term as Head of State. Executive power is vested in the Government, headed by a Prime Minister, nominated by the President after being appointed by the Parliament. Estonia is a unitary country with a single-tier of subnational government. The local government system is enshrined in Chapter 14 of the 1992 political constitution, entitled “Local Government”. Moreover, Art.2 of the Constitution states that “the division of territory into administrative units shall be provided by law”, and Art. 155 established rural municipalities and towns as the basic units of local government. Other units of local government may be formed on the basis of and pursuant to procedure provided by law. Estonia introduced online voting first in the local elections of 2005 and the system has been in place ever since.

Local authorities are represented by local councils, whose members are elected by direct local elections for a four-year term, according to the Municipal Council Election Act (2002). Members of the councils then elect a chairperson, and appoint a mayor, who is tasked with representing the local authority, as well as managing the municipal administration together with the chairperson. Decentralisation was re-established in Estonia in 1989 by the Local Government Act, which was followed by the 1993 Local Government Organisation Act, which abolished counties as a tier of local government (they became part of the State territorial administration). In 2015, the government launched a territorial reform promoting municipal mergers, which led to the adoption of the Territorial-Administrative Reform Act.

TERRITORIAL ORGANISATION

2018	MUNICIPAL LEVEL	INTERMEDIATE LEVEL	REGIONAL OR STATE LEVEL	TOTAL NUMBER OF SNGS
	15 urban municipalities *(linnad)*[1] and 64 rural municipalities *(vallad)*			79
	Average municipal size: 16 653 inhabitants			
	79			79

1. Five urban municipalities also have a rural area in their territory. For example in City of Pärnu (as municipality) about 76% of inhabitants are living in city area and 24% in rural areas. Pärnu City area is about 4% of the territory of Pärnu City as municipality.

OVERALL DESCRIPTION. Estonia has a single tier of SNG comprising 79 municipalities in 2018. Among these 79 municipalities, 15 are urban (*linnad*) and 64 are rural (*vallad*) all with the same legal status.

MUNICIPALITIES AND INTER-MUNICIPAL COOPERATION. The number of municipalities has gradually been decreasing since the 2004 Act on the Promotion of Local Government Mergers. Through the 2016 Administrative Reform Act, the Estonian government implemented a territorial reform and municipal merger programme, aiming to strengthen the administrative and developmental capacity of local governments. Following the reform law, the legislation set a minimum threshold of 5 000 inhabitants for municipalities (with some exceptions, such as for small islands). Municipalities that did not meet the criteria had to merge. The process was carried out in two stages: first, starting in 2016 until 1 January 2017 with voluntary mergers; then, the remaining received merger proposals from the government. The reform ended in October 2017 with the regular local council elections. Following this reform, the number of municipalities decreased from 213 to 79, and the median population of local governments increased from 1 887 to 7 739. As of 2018, 70% of municipalities have between 5 000 and 20 000 inhabitants, and only 21% have fewer than 5 000 inhabitants. Municipalities have the legal possibility to create sub-municipal entities called districts (*linnaosa*) in cities and parishes (*osavald*) in rural municipalities. They have a limited self-governing status (own governing assembly) and depend on their municipality. However, it is optional and eight municipalities, including Tallinn, have seized this opportunity as of today.

Inter-municipal cooperation is also encouraged through the 1993 Local Government Organisation Act, which defined a framework for voluntary inter-municipal bodies performing non-mandatory tasks on behalf of local authorities. Local governments have established formal cooperation in public transport, waste management, water and sewage for example. The last local government reform was also aimed at improving horizontal coordination. Following the reform, municipalities received some new tasks for joint implementation: county development activities; organising public transportation at the county level (via regional transport centres formed by municipalities and the Road Office); and coordination of regional health care; security councils; and cultural cooperation.

Until 1 January 2018, the State territorial administration comprised 15 County Governments, which were administrative subdivisions led by governors appointed by the central government. As a part of the state reform, County Governments were abolished and their tasks were reorganised and transferred either to the central administration or municipalities and inter-municipal groupings. A new department of Regional Administration was established in the Ministry of Finance, which overtook part of the functions of county governments. The department has small agencies with 3-6 employees in each county, for a total of 67 employees (instead of around 480 employees previously).

SUBNATIONAL GOVERNMENT RESPONSIBILITIES

Local government responsibilities are set by the Constitution, the Local Government Organisation Act of 1993 and specific laws (for example Social Welfare Act, Republic of Estonia Education Act, Basic Schools and Upper Secondary Schools Act, etc.). Municipal competences encompass the sectors of education, social welfare, housing and utilities, and local transport, etc. (see table below).

With the legislative amendments in 2017 (in force since 1 January 2018) some competences of the county governments were redistributed among local councils for joint implementation, such as the organisation of public transport, land reform procedures, and composition of county development strategy. Ministries took the lead on the supervision in different sectors relating to educational institutions, land ownership and the cadastre, and setting up local development plans. In 2001, an important health reform led to the privatisation of health, which was previously a responsibility carried out by municipalities and central government. Through the successive amendments to the Social Welfare Act (originally enacted in 1995), local governments have been given more flexibility in the provision of the subsistence benefit and care possibilities, and in organising the provision of high-quality early childhood education based on the needs of families. Continuing decentralisation and assigning of responsibilities to municipalities is an ongoing process following the 2016 territorial reform

Local authorities may provide certain public services through the private sector. They may also establish agencies or joint agencies with other local authorities for the provision of services. They can also be a partner or shareholder in a company, create foundations or be a member of a non-profit association.

MAIN RESPONSIBILITY SECTORS AND SUB-SECTORS

	MUNICIPAL LEVEL
1. General public services	Issuance of building ordinances and permits
2. Public order and safety	
3. Economic affairs/transports	Local public transportation; Construction and maintenance of local roads
4. Environmental protection	Waste management
5. Housing and community amenities	Water supply; Sewerage; Public lighting; Central heating and amenities; Spatial planning; Cemeteries; Housing and utilities
6. Health	
7. Recreation, culture & religion	Cultural facilities; Youth work; Libraries; Community centres; Museums; Sports facilities
8. Education	Maintenance of pre-school child care institutions, primary and secondary schools; Payment of teachers salaries.
9. Social protection	Provision of social services; Social benefits grants and other social assistance; Welfare services for the elderly; Shelters and care homes

SUBNATIONAL GOVERNMENT FINANCE

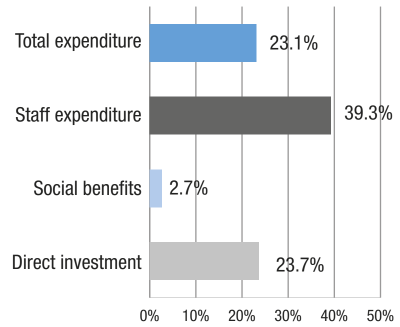
Scope of fiscal data: local governments and organisations managed by local governments, local government foundations, local government hospitals, and local government enterprises.	SNA 2008	Availability of fiscal data: **High**	Quality/reliability of fiscal data : **High**

GENERAL INTRODUCTION. The basic legal provisions regarding local government financing are set by the Constitution (Art. 157), which states that local authorities have independent budgets and have the legal right to levy and collect taxes, and to impose duties. The major legal act in this regard is the 2010 Local Government Financial Management Act. Currently, local governments have very limited powers and incentives to increase their own revenues. As a result, local governments are overwhelmingly dependent on state grants and transfers. The State meets local governments at the annual Budget Negotiation Workgroup, established by the government and the delegation of the National Local Government Association. The financial and tax policy workgroup, formed by the Ministry of Finance and the local governments, is the forum during which the support allocated to local authorities, as well as their cost base and other matters concerning tax policy, are discussed.

SUBNATIONAL GOVERNMENT EXPENDITURE BY ECONOMIC CLASSIFICATION

2016	DOLLARS PPP / INH.	% GDP	% SNG EXPENDITURE
Total expenditure	**2 798**	**9.4%**	**100%**
Inc. current expenditure	2 432	8.2%	86.9%
Staff expenditure	1 376	4.6%	49.2%
Intermediate consumption	833	2.8%	29.8%
Social expenditure	112	0.4%	4.0%
Subsidies and current transfers	99	0.3%	3.5%
Financial charges	11	0.0%	0.4%
Others	1	0.0%	0.0%
Incl. capital expenditure	365	1.2%	13.1%
Capital transfers	31	0.1%	1.1%
Direct investment (or GFCF)	334	1.1%	11.9%

% GENERAL GOVERNMENT EXPENDITURE (SAME EXPENDITURE CATEGORY)



ESTONIA

UNITARY COUNTRY

EXPENDITURE. Municipalities in Estonia are responsible for 23.1% of government expenditure in 2016, representing 9.4% of GDP, relatively far below the OECD average (respectively 40.4% and 16.2%) but close to the OECD average for unitary countries (28.7% of public expenditure and 9.2% of GDP). An important part of local expenditure is financed via earmarked grants from the state budget, meaning that municipalities have very limited autonomy regarding the manner in which they perform their tasks. Current expenditures represented 87% of subnational expenditure. It was composed primarily of subnational staff expenditure, whose share in public staff spending is significant, especially since municipalities are responsible for teacher salaries.

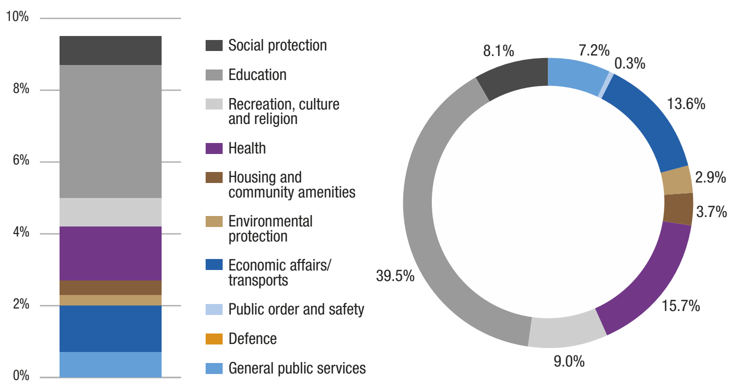
DIRECT INVESTMENT. The share of SNGs in public investment is well below the average of OECD countries (56.9% of public investment and 1.7% of GDP). Most municipal investment was dedicated to transport infrastructure, and particularly local roads, public transport, tourism and business infrastructure, followed by education infrastructures and recreation and culture. In contrast, municipalities invest very little in social protection, housing or general public services. Estonia is a major beneficiary of the European Structural and Investment Funds (ESI Funds), which play a significant role at the municipal level, funding projects like schools, child-day centres, etc. At the national level, the government plans to allocate 1.3% of GDP to infrastructure investment over the period 2018-20, 40% of which will be directed to the transport sector. The implementation of a programmed budgeting system is being discussed, where planned costs, revenue, investments and financing transactions in the annual state budget, would be presented on a regular basis as a way to increase the public management performance both at the national and subnational level.

SUBNATIONAL GOVERNMENT EXPENDITURE BY FUNCTIONAL CLASSIFICATION – COFOG

The largest SNG expenditure category is by far education, as municipalities are responsible for both current and capital expenditure in this area, accounting for 3.7% of GDP and for 39.5% of SNG expenditure, above the OECD average of 24.8% in 2016. Health is another important spending area, since SNGs are responsible for health care institutions. They account for almost 16% of SNG expenditure. Together, education and health represent 55.2% of subnational expenditure.

Housing and community amenities stand for 99.5% of general government expenditure in the same category, which means that this is an almost exclusive competence of municipalities. However, spending in this category only amounted to 0.4% of the GDP in 2016. On the other hand, the share of SNG spending dedicated to general services remains amongst the lowest across the OECD (14.1% on average as a share of SNG expenditure in 2016).

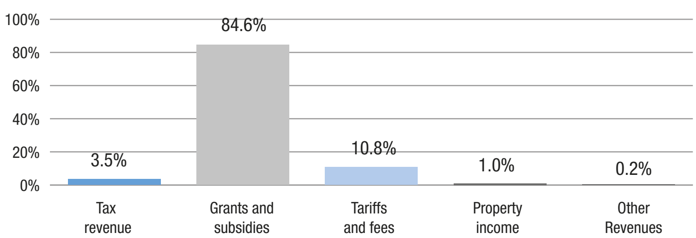
% GDP | % SNG EXPENDITURE



SUBNATIONAL GOVERNMENT REVENUE BY CATEGORY

2016	DOLLARS PPP / INH.	% GDP	% GENERAL GOVERMENT REVENUE (SAME REVENUE CATEGORY)
Total revenue	**2 835**	**9.5%**	**23.6%**
Tax revenue	100	0.3%	1.5%
Grants and subsidies	2 397	8.1%	
Tariffs and fees	305	1.0%	
Property income	27	0.1%	
Other revenues	6	0.0%	

% SNG REVENUE



OVERALL DESCRIPTION. Estonian municipalities, especially those in rural areas, do not have many possibilities of shaping their revenues, composed for the major part of central government transfers. The share of grants and subsidies as part of SNG revenue is much larger in Estonia than the OECD average (37.2% in 2016), whereas the share of tax revenue in SNG revenue is much lower than in the rest of OECD unitary countries (44.6% in 2016), Estonia ranks last among OECD countries in 2016. It is important to note that before the 2008 reform of the SNA (implemented in 2014), revenues coming from the sharing of national taxes such as the personal income tax (PIT) were considered tax revenue while, since the reform, they are considered grants from the federal government, hence the strong decrease of the tax ratio in Estonia.

The fiscal autonomy of municipalities is therefore very limited. Only the wealthiest municipalities (around 20% of the total) have self-financing capacities. Even in the case of the capital-city of Tallinn, in 2016, the municipal budget was composed for 60% of transfers (based on the redistribution of the PIT), for 16% of other transfers from the state, for 11% from the sale of goods and services and for 5% from own-source revenue from the land tax.

TAX REVENUE. Overall, the share of tax revenue in local revenue is negligible, in particular since the implementation in 2014 of the 2008 SNA methodology which reclassified some shared taxes as transfers. Estonia is the most centralised country of the OECD regarding taxation, tax revenue accounting for only 0.3% of GDP and 1.5% of public tax revenue (to be compared to 4.7% of GDP and 19.8% of public tax revenue in OECD unitary countries on average). Additionally, municipalities have limited autonomy to introduce new taxes.
The main component of local taxes is the land tax. Land tax is a tax based on the taxable value of land only (improvements are not taken into consideration).

It is calculated by the Estonian Tax and Customs Board on the basis of information received from the corresponding local government. The land tax is considered a state level tax but 100% of its receipts go to local government budgets. In addition, municipalities have a degree of freedom to set the rates, within limits set by law. In particular, the tax rate on land is legally set at 0.1-2.5% of the taxable value of land annually. The rate on agricultural land is 0.1–2.0%. There are very few exemptions on the land tax. Land values have not been re-evaluated since 2001. The land tax accounted for 83.6% of municipal tax revenue and 2.9% of their total revenue in 2016. It amounted to 0.3% of GDP, which is well below the OECD average (1.1% of GDP).

Municipalities also collect other minor local taxes, which are optional according to the Local Taxation Act, such as the tax on advertising (7% of SNG tax revenue), tax on the use of water (7%) and tax on closure of roads, streets and squares (2%.).

GRANTS AND SUBSIDIES. Local governments are overwhelmingly dependent on state grants and transfers, which make up to 85% of total local revenue. Most municipal grant revenues come from the sharing, with the central government, of PIT receipts. The share of the PIT allocated to local governments through the Tax and Custom Board was set at 11.6% of taxable income in 2016 (provided that any statutory deductions from the taxable income base (standard tax deduction, etc.) will only subtract from central government PIT revenue and leave municipalities income tax revenues untouched).

The second biggest source of grants are earmarked block grants, which include the education grant (in particular for teachers' salaries) and the social benefits grant. Grants are calculated using more than 50 different formulas. Reforms are currently being considered to reduce earmarked transfers and improve efficiency by moving to a more performance-based system.

Grants also include the Equalisation Fund scheme, which ensures the redistribution of revenue to poorest municipalities (section 47 of the 2014 State Budget Act, amended in 2017). Equalisation transfers are defined yearly in the state budget. They are formula-based, according to the population size, revenues over the last three years (PIT and land tax), and the municipality's "estimated expenditure needs" (based on the funds available). Since 2017, it was established that the equalisation grant should not decrease by more than 2% of "expenditure needs" a year, as an incentive for municipalities to look for ways to increase their revenues. The addition of another component to the formula, defined as "peripheral region", has been implemented since 2018. In 2016, 173 municipalities out of 213 benefited from this equalisation fund, whose amount reached EUR 7.6 million.

Local governments also receive capital grants, including EU funds which finance approximately one-third of their total investment. Capital grants accounted however for only 3.2% of total grants in 2016. Finally, in the framework of the Administrative Territorial Reform, local governments that carried out successful merger negotiations received specific grants, of varying amounts according to the procedure and size of the merger.

OTHER REVENUES. Other revenues for local governments include user charges, fees and revenues from economic activities, which account for around 10.8% of municipal revenues, a smaller percentage compared to the OECD average of 14.9% in 2016. Property income (rents and sales of assets) is 100% local, and stands for 1% of SNGs revenue, in line with the OECD average of 1.4%

SUBNATIONAL GOVERNMENT FISCAL RULES AND DEBT

2016	DOLLARS PPP/INH.	% GDP	% GENERAL GOVERNMENT DEBT	% SNG DEBT
Total outstanding debt	**706**	**4.2%**	**31.9%**	**100%**
Financial debt*	568	3.4%	35.7%	80.4%

* Currency and deposits, loans and bonds

FISCAL RULES. The 2014 State Budget Act introduced a budget balance rule for the general government, with a breakdown by level of government. The text states that the operating results shall not be negative at the end of an accounting year. It also provides for a "recovery plan" to re-establish fiscal discipline, which may include the amendment of local government legislation on the revenue and the expenditure sides. In 2016, only one local government was in a perilous financial situation. The State Budget Act enacted in 2014 established the Fiscal Council, which strengthened the overall fiscal framework. The National Audit Office, an independent public body, reports to the Parliament on the financial situation of central and local levels of government, as well as on other issues such as transparency and the prevention of corruption. It is headed by the Auditor General, who is recommended by the President and appointed by the Parliament for a term of five years. However, internal audit mechanisms are not yet mandatory for local authorities.

DEBT. Municipalities can contract long-term loans or bonds but only to fund investment projects (golden rule). According to the 2010 Local Government Financial Management Act (LGFMA), the debt ceiling for local governments ranges from 60% to 100% of the current year's operational revenues (depending on their self-financing capacity). The weight of local debt in GDP is significantly lower than the OECD average for unitary countries (14.5% of GDP in 2016). As a share of public debt, it is however significantly higher (11.8%). This is explained by the low level of public debt (13.1% of GDP vs 16.6% of GDP in the OECD on average in 2016). In 2016, financial debt ("Maastricht debt") accounted for 80% of total outstanding debt, the remaining part being composed of "other accounts payable" (commercial debt and arrears). Financial debt is made up primarily of loans (76.5%) and to a lesser extent of bonds (23.5%).

SNGWOFI
World Observatory on Subnational Government Finance and Investment

Lead responsible: OECD
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Socio-economic indicators: OECD // Eurostat // World Bank // UNDP // UN Desa // ILO // Statistics Estonia.
Fiscal data: OECD National Accounts Statistics // OECD Revenue Statistics // OECD (2018) Subnational Government in OECD countries: key data (brochure and database) // Eurostat // Statistics Estonia // Estonia Tax and Custom Board.
Other sources of information: Ministry of finance of Estonia (2019) Local Government System in Estonia https://www.rahandusministeerium.ee/en/local-governments-and-administrative-territorial-reform // IMF (2018) Selected Issues paper on the Republic of Estonia – IMF Country Report No. 18/126 // OECD (2017) OECD Economic Surveys: Estonia 2017 // European Commission (2017), Country Report Estonia 2017 // Congress of Local and Regional Authorities (2017) Local democracy in Estonia // OECD (2016) "Estonia", in OECD Regional Outlook 2016: Productive Regions for Inclusive Societies // European Committee of Regions (2016) Division of Powers // Sulev Maeltsemees S., Lõhmus M., and Ratas J. (2013) Inter-Municipal Cooperation: Possibility for Advancing Local Democracy and Subsidiarity in Estonia.