

## ESTONIA

- The GDP per capita gap vis-à-vis the upper half of OECD countries is substantial. This gap in living standards reflects a shortfall in productivity, where convergence has slowed. Labour market participation is high, but structural unemployment remains elevated.
- Spending on activation policies has been increased but remains low. The tax wedge on labour has been reduced, but efforts should be pursued in this area, especially for low-pay workers. The new means-tested student support system should facilitate access to tertiary education.
- Improving vocational education and training (VET) as well as access to tertiary education, encouraging business innovation, and addressing shortfalls in energy market regulation would reduce the productivity gap. Strengthening active labour market policies and reducing the labour tax wedge for low-wage earners would help combating structural unemployment.
- Strengthened active labour market and education policies as well as a pro-poor tax wedge reduction would not only stimulate growth, but also make it more inclusive. A shift to environmental taxation and effective regulation of energy markets would promote green growth.

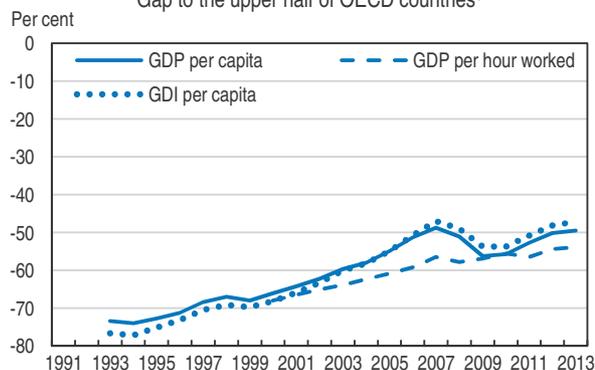
### Growth performance indicators

#### A. Average annual trend growth rates

Per cent

	2003-08	2008-13
Potential GDP per capita	4.1	1.8
Potential labour utilisation	0.2	0.2
of which: Labour force participation rate	0.2	0.1
Employment rate <sup>1</sup>	0.2	0.2
Trend employment coefficient <sup>2</sup>	-0.2	-0.2
Potential labour productivity	3.9	1.7
of which: Capital deepening	2.5	1.3
Labour efficiency	1.2	0.5
Human capital	0.1	-0.1

#### B. Convergence in GDP per capita has resumed

Gap to the upper half of OECD countries<sup>3</sup>

1. The employment rate is defined with respect to the economically active population; a positive growth rate corresponds to a decline in the structural unemployment rate and vice versa.
2. This adjustment variable is added to the decomposition to capture the impact of non-resident workers.
3. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita, GDP per hour worked and GDI per capita (in constant 2005 PPPs).

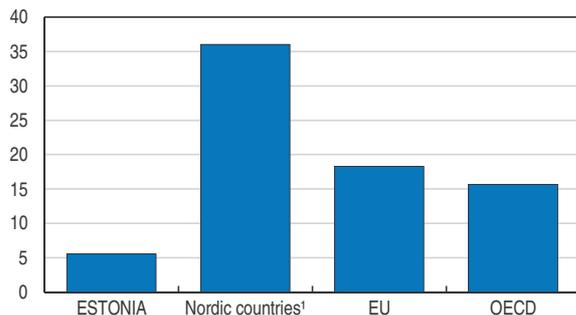
Source: Panel A: OECD, *Economic Outlook 96 Database*. Panel B: OECD, *National Accounts and Productivity Databases*.

StatLink  <http://dx.doi.org/10.1787/888933177756>

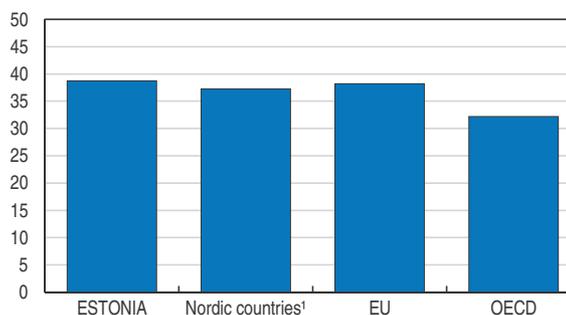
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## Policy indicators

**A. Active labour market policies are underdeveloped**  
Public expenditure per unemployed, as a percentage of GDP per capita, 2012



**B. The labour tax wedge is comparatively high for low-income workers<sup>2</sup>**  
Percentage of total labour compensation, 2013



1. Average of Denmark, Finland, Norway and Sweden.

2. Labour taxes include personal income tax and employee plus employer social security contributions and any payroll tax less cash transfers. Single person at 67% of average earnings without children.

Source: Panel A: OECD, *Public expenditure and participant stocks on LMP and Economic Outlook Databases*. Panel B: OECD, *Taxing Wages Database*. StatLink  <http://dx.doi.org/10.1787/888933178184>

## Going for Growth 2015 priorities

### Priorities supported by indicators

**Strengthen active labour market policies.** High long-term unemployment, a high share of disability benefit recipients and skills mismatches reduce potential output.

**Actions taken:** Spending on activation policies increased in 2014, but remains low in international comparison. New active labour market programmes were introduced in 2014, targeted at risk groups, e.g. the long-term unemployed and youth.

**Recommendations:** Further increase overall spending on activation policies and target them at key risk groups. Target wage subsidies towards low-wage earners. Encourage stronger involvement of employers in the choice of training courses and enhance their quality. Reform the disability benefit system by expanding access to activation measures for individuals with disabilities and by strengthening the assessment of work capabilities. Involve employers in prevention and rehabilitation measures.

**Reduce labour taxation by shifting the burden to less distortive sources.** High labour tax wedges reduce employment opportunities, particularly among the low-skilled.

**Actions taken:** The unemployment insurance contribution rate was reduced, from 4.2% to 3% in 2013 and to 2.4% at the beginning of 2015. The income tax-free allowance was raised, from EUR 145 to EUR 154 in 2014. The flat income tax rate will be reduced from 21% to 20% in 2015. Exemptions from VAT for privately used company cars will be limited and the efficiency of VAT tax collection raised. Tobacco and alcohol taxes were increased between 2013 and 2015. However, taxation of the land underneath detached houses was abolished in 2013.

**Recommendations:** Reduce labour taxation, focusing on low-wage earners. Remove distortive personal income taxation exemptions, notably for mortgage payments. Increase environmental and real estate tax revenues, for instance by aligning tax rates on the various energy sources according to their CO<sub>2</sub> emission content, by removing exemptions in the taxation of land and by making use of market-based valuation for assessing real estate taxes.

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**Enhance the effectiveness of innovation policies.** Weaknesses in the institutional framework and implementation of innovation policies hamper knowledge transfers and productivity catch-up.

**Actions taken:** The government adopted a new smart specialisation strategy in 2013. It identifies three priority areas for growth: information and communications technology, healthcare and more efficient use of resources. Responsibilities for R&D policies were clarified and co-ordination across ministries was strengthened. Indicators were developed to measure the effectiveness of innovation policies.

**Recommendations:** Streamline the institutional framework for research and innovation. Enhance monitoring and evaluation of support schemes. To strengthen knowledge transfers to domestic firms, promote applied research and encourage the collaboration of firms with domestic and foreign institutions conducting applied research.

### Other key priorities

**Promote efficiency in the regulation of energy markets.\*<sup>1</sup>** Current regulation of energy industries and limited network integration with the EU contribute to high energy consumption and CO<sub>2</sub> emissions, damping productivity performance and sustainable growth prospects in the long-term.

**Recommendations:** Gradually align and raise tax rates on energy sources according to the externalities they generate. Continue to integrate gas and electricity networks with the EU. Strengthen incentives to improve efficiency in the regulation of heating networks.

**Improve quality of vocational education and training and access to tertiary education.** Low quality of vocational education and training and poor access to tertiary education complicate school-to-job transitions.

**Actions taken:** A task force was set up in 2014 to develop policy tools aimed at improving the matching between supply and demand of skills. Recent reforms in this area have focused on e.g. increasing practitioners' involvement into vocational education and promoting entrepreneurship training. A new means-tested grant system for university students was launched in 2013.

**Recommendations:** Further strengthen incentives for employers to offer apprenticeship places for youth in vocational education. Introduce a tax-free lower minimum wage for apprenticeships and improve financial support for students in vocational education. Strengthen collaboration of businesses and schools at the local level. Continue to step-up means-tested support for university students. Expand the student loan system and consider making repayment contingent on income.

## Reform areas no longer considered a priority in *Going for Growth*

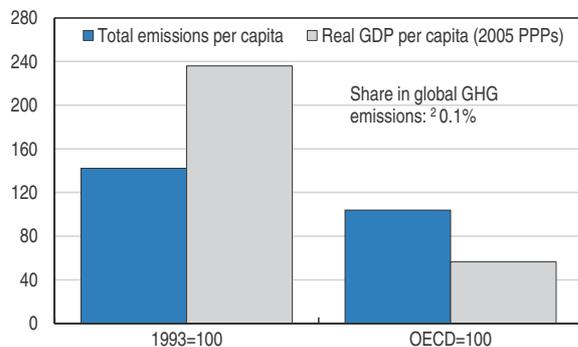
For Estonia, all priority areas from the 2013 issue of *Going for Growth* are maintained.

1. New policy priorities identified in *Going for Growth 2015* (with respect to *Going for Growth 2013*) are preceded and followed by an "\*\*\*".

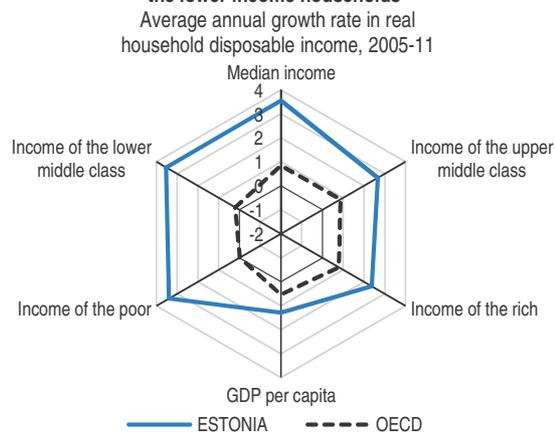
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## Beyond GDP per capita: Other policy objectives

**A. Emissions per capita are close to OECD average**  
Average 2008-12<sup>1</sup>



**B. Despite low growth in GDP per capita, real incomes have increased, especially among the lower income households<sup>3</sup>**



1. Total GHG emissions including LULUCF in CO<sub>2</sub> equivalents (UNFCCC). The OECD average (excluding Chile, Israel, Korea and Mexico) is calculated according to the same definition.
2. Share in world GHG emissions is calculated using International Energy Agency (IEA) data.
3. Household income across the distribution is measured by income standards with varying emphasis on different points of the distribution – from the low to the top-end of the distribution. See methodological notes at the end of the chapter for the computation of household income across the distribution.

Source: Panel A: OECD, *National Accounts and Energy (IEA) Databases*; and *United Nations Framework Convention on Climate Change (UNFCCC) Database*. Panel B: OECD, *National Accounts and Income Distribution Databases*.

StatLink  <http://dx.doi.org/10.1787/888933178612>