OECD Public Governance Reviews

ESTONIA

TOWARDS A SINGLE GOVERNMENT APPROACH



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OECD Public Governance Reviews: Estonia

TOWARDS A SINGLE GOVERNMENT APPROACH



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Foreword

This report is the third in a series of OECD country reviews that help countries assess their public governance and public management arrangements from a comprehensive and international comparative perspective. These reviews seek to help governments identify how they can better deliver on their objectives, as well as their preparedness to meet current and future challenges.

The report builds on OECD experience in conducting peer reviews. It draws on an extensive review of information about public governance and the operations of public administration in Estonia, and a series of interviews held in 2010 with Estonian public officials at the national and sub-national levels, academics, civil society and non-governmental organisations, and private sector representatives.

In undertaking a public governance review of Estonia, the OECD analysed how a single-government approach could be fostered within the government, and particularly in the public administration, in order to promote a better performing government at all levels and to improve central and sub-national public service delivery.

Completed in February 2011, the review was carried out under the auspices of the OECD Public Governance Committee as part of the work programme of the Public Governance and Territorial Development Directorate (GOV). It was financed by the Estonian government with the financial assistance of the European Union, through the European Social Fund (programme: "Better Public Services, Public Governance Review"). The report was led by M. Varinia Michalun of the OECD Secretariat; written by Lisa Arnold, Edwin Lau, Jean-François Leruste and M. Varinia Michalun, with statistical analysis from Jean-François Leruste. Additional thematic contributions were made by Marco Daglio, Marie Petrmanova, Barbara Ubaldi and Andrea Uhrhammer. The report also benefited from consultant contributions by Janet Looney (US) for the case study on education, Antti Moisio (Finland) for a report on sub-national finance in Estonia, and Sigurbjörg Sigurgeirsdóttir (Iceland) for the case study on social services. Administrative and production assistance was provided by Julie Lamandé, and editing by Melissa Peerless.

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Table of Contents

Glossary of Terms 11

Executive Summary 13

Chapter 1. **Main Assessment and Key Recommendations** 17
Overview 18
Promoting a whole-of-government approach in public administration 23
Building a common agenda. 34
Delivering public services effectively 44
Conclusion 57
Key recommendations 59
Notes. 70

Chapter 2. **The Role of the State Following Economic Success** 71
Introduction. 73
Estonia: A regained independence 74
Estonia between 1991 and 2010: Four stages of economic development 74
Estonia's public finances 84
Social performance. 85
Economic Outlook. 94
Notes. 95

Chapter 3. **Public Governance Arrangements in Estonia** 97
Introduction. 98
Estonia's institutional framework 98
Estonia's public administration 103
Identifying challenges to successful public administration reform 110

Chapter 4. **Promoting a Whole-of-Government Approach** 115
Introduction. 116
The elements of a "whole-of-government" approach. 117
Promoting co-ordination, co-operation and collaboration in the public administration 121
Creating a supporting organisational culture. 137
Building a flexible public administration 153
Notes. 171

Chapter 5. **Building a Common Agenda** 173
Introduction. 174
Enhancing cross-sectoral strategic planning 174

Modernising the performance and budget system . . . 188
Establishing frameworks for effective decision making . . . 210
Notes . . . 226

Chapter 6. **Delivering Public Services Effectively** . . . 227
Introduction . . . 228
Overview: Choices and priorities . . . 229
Reinforcing the sub-national financing and administrative structure to ensure sustainable public services . . . 239
Supporting innovative service delivery for efficient, effective and accessible public services . . . 260
Improving relationships across levels of government to enhance service delivery and policy outcomes . . . 279
Taking territorial needs into account for service delivery and regional development . . . 295
Conclusion . . . 301
Notes . . . 302

Chapter 7. **Case Study One: Estonian Education – Sustaining High Quality Schools** . . . 305
Introduction . . . 306
Background and context . . . 307
The suitability of the current financing system for supporting general education, and alternative approaches . . . 314
The capacity of local governments to provide high quality education . . . 327
Nationally run general upper secondary schools . . . 333
Re-drawing the boundaries of school catchment areas . . . 334
Recommendations for sustaining high-quality education in Estonia . . . 337
Conclusions . . . 339
Notes . . . 341

Chapter 8. **Case Study Two: Social Services for the Elderly in Estonia** . . . 343
Introduction . . . 344
The Estonian context . . . 346
A fragmented system of care for the elderly . . . 353
The international policy context . . . 362
The challenge for Estonia . . . 366
Recommendations . . . 369
Conclusions . . . 381
Notes . . . 384

Bibliography . . . 385

Annex A. Overview of Accrual Accounting and Budgeting Practices in Individual Countries . . . 393
Annex B. Working Age Population Dispersion . . . 395
Annex C. Management and Consultation . . . 396

Tables

1.1. Performance Budgeting: Summary of country implementation strategies ... 38
1.2. Municipal revenue sources, 2003-09 ... 52
2.1. Basic Statistics of Estonia, 2009 ... 72
2.2. Foreign trade, 2009 ... 79
2.3. Value added by economic activity ... 81
2.4. Regional disparities ... 82
2.5. Economic Outlook for Estonia: Demand output and prices ... 95
3.1. Ministries and ministers in Estonia ... 100
3.2. Parliamentary election results, 6 March 2011 ... 102
3.3. Employees in the public sector, 2009 ... 103
3.4. Ministries, their subordinate agencies and foundations established by the ministries ... 106
3.5. Size of the public service, 2007-09 ... 107
4.1. Administrative elements of government stewardship ... 126
4.2. What values and attitudes distinguish public service from other sectors? ... 145
4.3. Obstacles to improving public sector ethics in Estonia, 2005 and 2009 ... 146
4.4. Measures to reinforce public service ethics in Estonia, 2005 and 2009 ... 147
4.5. Proportion of employees who moved between departments/ministries ... 155
4.6. Distribution of officials by education level, as at 31.12.2009 ... 168
5.1. Timetable for budget formulation ... 192
6.1. Municipal tasks, 2003-09 ... 229
6.2. Municipal revenue sources, 2003-09 ... 236
6.3. Type of sub-national tax level ... 236
6.4. Grants to municipalities in 2010 ... 238
6.5. Comparison of voter turnout in local elections ... 243
6.6. Commune typology under the proposed Integrated Concept of Territorial and Administrative Reform in the Grand-Duchy of Luxembourg ... 246
6.7. Percentage drops in county administrative staff ... 264
6.8. Examples of ministerial organisation of regional authorities ... 282
6.9. Some tools for bridging the co-ordination and capacity gaps ... 291
6.10. Examples of indicators used by different OECD countries to measure sub-national service ... 294
6.11. Paradigm shift of regional development policy ... 300
8.1. Retired people with long-standing illness or health problem, 2004-08 ... 348
8.2. Self perceived limitations in daily activities among retired people, 2004-08 ... 348
8.3. Social and health care responsibilities for the elderly in Estonia ... 354
8.4. An illustration of mixed funding based on the principle of individual rights and responsibilities and “money-follows-the-patient” ... 376
A.1. Accounting basis applied to budget approved by legislator ... 393
A.2. Accounting basis applied to consolidated (whole-of-government) financial statements ... 394
C.1. OECD interviews: Political level ... 396
C.2. OECD interviews: State public administration ... 397
C.3. OECD interviews: Sub-national level ... 397
C.4. Other OECD interviews ... 398

Figures

1.1. GDP, Government expenditure and revenue, 1996-2008 . . . 19
1.2. Public expenditure as a percentage of GDP, 2008 . . . 19
1.3. Total government expenditure by function, 2008 . . . 20
1.4. Public budget balance: Difference between 1995 and 2009 . . . 21
1.5. Unemployment rate, September 2010 . . . 22
1.6. Values in Estonian Public Service, 2005 and 2009 . . . 29
1.7. Distribution of officials by age as of 31 December 2009 . . . 32
1.8. Employment in general government, 2008 . . . 33
1.9. Distribution of state officials by age, 2009 . . . 43
1.10. Sub-national revenue as a percentage of general government revenue, 2009 51
1.11. Sub-national expenditure as a percentage of general government expenditure, 2009 . . . 51
2.1. 1991-2010: Four stages of economic development . . . 75
2.2. Average annual real GDP growth in the OECD and CEE countries, 1996-2007 . 76
2.3. Real GDP growth, 1996-2007 . . . 76
2.4. Macroeconomic indicators, 1996-2012 . . . 77
2.5. GDP per capita, 1995-2008 . . . 78
2.6. Country openness, 2008 . . . 79
2.7. Unemployment rates at the national, regional and county levels, 2004 and 2009 . . . 82
2.8. General government debt, 2007-09 . . . 84
2.9. Share of government expenditure, 2000 and 2008 . . . 85
2.10. Real GDP and public expenditure growth, 2000-08 . . . 85
2.11. Structure of general government expenditures by function, 2008 . . . 86
2.12. PISA 2009 – Average student performance on the mathematics scale . . . 87
2.13. General government expenditures on social protection, 2008 . . . 87
2.14. At-risk poverty rate of population aged 65 and over, 2001 and 2009 . . . 88
2.15. Telecommunication infrastructure index, 2010 . . . 89
2.16. E-Government sophistication index, 2009 . . . 89
2.17. E-Government full online availability index, 2009 . . . 90
2.18. E-Government user take-up, 2007 and 2009 . . . 90
2.19. Elderly population aged 65 and over . . . 91
2.20. Population over 65 by region, 1995-2009 . . . 92
2.21. Unemployment rate, September 2010 . . . 92
2.22. Disposable income . . . 93
3.1. Number of staff employed in the public administration, 2000-09 . . . 104
3.2. Labour force structure: Employment in public and private sector and unemployment, 2000-09 . . . 104
3.3. Employment in general government, 2008 . . . 105
3.4. Share of employment in central government within total employment, 2008 107
4.1. Systemic elements of public governance . . . 118
4.2. Responsibility for co-ordinating horizontal issues . . . 127
4.3. Values in Estonian public service, 2005 and 2009 . . . 144
4.4. Extent of the use of performance assessments in HR decisions in central government, 2005 . . . 149
4.5. Number of annual performance assessment interviews conducted, 2005-09 149

4.6. Extent of the use of performance-related pay in central government, 2005 . . 151
4.7. Distribution of public servants who left the service, according to their new position, 2009 154
4.8. Administrative structure of an Estonian ministry 160
4.9. Distribution of state officials according to age, 1998-2009 165
4.10. Labour force age structure: Total employment and state officials, 2009. 166
4.11. Age distribution of officials as of 31 December 2009 166
4.12. Public administration training costs, 2005-09 168
5.1. Strategic planning in Estonia 179
5.2. State administration reporting 184
5.3. Coverage and frequency of long-term fiscal projections by central government, 2007. 190
5.4. Strategic planning in Estonia showing area of responsibility 193
5.5. Hierarchy of performance management levels used to form strategic objectives 199
5.6. General government deficit/surplus 202
5.7. Budgetary process in 2009 204
5.8. Real GDP growth, fiscal balance and consolidated gross debt, 1996-2012. 205
5.9. Workflow of government decision making in Estonia 211
5.10. Barriers to stakeholder participation with the state public administration, 2010 220
5.11. Identified barriers to government agencies undertaking stakeholder engagement, 2010 222
6.1. Main areas of sub-national public sector expenditure. 230
6.2. General public expenditure at the local government level, 2009 231
6.3. Change in Estonian municipal revenue, expenditures and debt, 2004-09 232
6.4. Local government debt in Estonia, 2010Q1 232
6.5. Local government debt, 2005Q4-2010Q1. 233
6.6. Expenditures development in main service categories 233
6.7. Frequency distribution of expenditures EEK/capita over municipalities, 2009 234
6.8. Municipal per capita tax revenues and population size, 2009 237
6.9. Municipal taxes to total taxes in Estonia compared to other OECD countries, 2005 238
6.10. The effect of the equalisation grant at different levels of municipal tax revenue, 2009 241
6.11. Municipal per capita revenues by population group, 2009 242
6.12. Number of Estonian municipalities by population group, 2009 244
6.13. Sophistication of 20 basic e-services, 2009. 266
6.14. Full online availability, 2009. 266
6.15. E-Government user take-up in OECD-EU member countries and Baltic States, 2007 and 2009 271
7.1. Percentage of teachers in schools where the principal reported the following pre-requisites or high priorities for school admittance, 2007-08 310
7.2. School autonomy factors, 2007-08. 312
7.3. Education funding, ISCED 0-6, 2007 313
7.4. Funding flows for municipal schools in Estonia 315
7.5. Ratio of students to teaching staff in educational institutions, 2007. 318

7.6. The impact of the new funding model on current educational expenses in the counties of Estonia, compared to the old funding model, 2008. 319
7.7. Minimum and maximum basic gross teacher salaries relative to per capita GDP, 2006-07 320
7.8. Minimum and maximum basic gross teacher salaries relative to per capita GDP, 2006-07 320
7.9. Minimum and maximum gross teacher salaries relative to per capita GDP, 2006-07. 321
7.10. Financial flows in education 325
7.11. Financial flows in education 325
8.1. Proportion of population aged 65 and over in selected OECD European countries, 2009. 346
8.2. Old-age dependency ratio in selected OECD European countries, 2009 347
8.3. Total expenditure on health as a % of GDP, 2007 349
8.4. Number of long-term care beds in hospitals, 2008 349
8.5. Public and private expenditure on healthcare, 2007 350
8.6. Private household out-of-pocket expenditure on healthcare in selected OECD countries, 2007 350
8.7. Old age pension per inhabitant in selectedOECD European countries, 2007 . . 351
8.8. At-risk-of-poverty rate of older people (65+) in selected OECD European countries, 2001 and 2009 351
8.9. Estonian population by age group and county, 2009 352
8.10. Expenditure on social protection, home service and caregiver's allowance for the elderly, by county, 2009 353
8.11. Total local government expenditure on social servicesfor the elderly, 2009 . . 354
B.1. Share of the working-age population by local government unit 395

Glossary of Terms

Capability	The skills-based ability for an individual, group or organisation to meet obligations and objectives; also referred to as "know-how".
Capacity	The ability to meet obligations and objectives based on existing administrative, financial, human, and infrastructure resources.
Central government	All units of government that exercise authority over the entire economic territory of a country. In general the Central Government is responsible for those functions that affect the country as a whole; for example, national defence, conduct of relations with other countries and international organisations, establishment of the legislative, executive and judicial functions that cover the entire country. Non-market, non-profit institutions controlled and mainly financed by the Central Government are included in the Central Government.
Civil servant/service	A term used by many OECD countries applied to core central public employment, *i.e.,* the employees in the central executive and legislative administration, in departments directly dependent on the Head of State or the Parliament, together with those in all other ministries and administrative departments of central government, including autonomous agencies paid by central government.
Collaboration	Co-operation together with direct peer-to-peer communication among organisations. "Collaboration" implies both joint action and a structured relationship among organisations.
Contracting-out	Contracting-out is the practice whereby governments contract with private sector providers for the provision of services to government entities or directly to citizens on behalf of the government. It is also referred to as outsourcing, contracting, and competitive tendering.
Co-operation	Joint intent on the part of individual organisations. "Co-operation" implies joint action, but it does not address the organisations' relationship with one another.
Co-ordination	Joint or shared information insured by information flows among organisations. "Co-ordination" implies a particular architecture in the relationship between organisations, but not how the information is used.
Co-production	A way of planning, designing delivering and evaluating public services which draws on direct input from citizens, service users and civil society organisations.
Decentralisation	The transfer of competences from the central level of government to elected authorities at the sub-national level(s).

Deconcentration	The placement of non-elected central government units in lower-level administrative units of government *(e.g.,* in regions, provinces, counties), in order to provide public services produced by the central government directly at the territorial level.
Effectiveness	The extent to which the activity's stated objectives have been met.
Efficiency	Achieving maximum output from a given level of resources used to carry out an activity.
Outcomes	Refers to what is ultimately achieved by an activity. Outcomes reflect the intended or unintended results of government actions, but other factors outside of government actions are also implicated.
Outputs	In performance assessment in government, outputs are defined as the goods or services produced by government entities *(e.g.,* teaching hours delivered, welfare benefits assessed and paid).
Performance	The ability of an entity to acquire resources economically and use those resources efficiently and effectively in achieving performance targets.
Performance information	Evidence about performance that is collected and used systematically. Performance information may be quantitative (numerical) or qualitative (descriptive). Its usefulness is enhanced through comparison and the ability to identify the extent to which interventions are achieving desired outcomes.
Performance measures	Performance measures are the inputs, processes, outputs and outcomes used to assess the economy, efficiency and effectiveness of an organisation's activities. They are quantitative or qualitative factors or variables that provide a means to measure achievement, to reflect the changes connected to an intervention, or to help assess performance.
Public-private partnership	A contract (institutional relationship) between public and private actors for the co-operative provision of a public good or service. The essential element is some degree of private participation in the delivery of traditionally public-domain goods or services. Private actors may include both for-profit and not-for-profit organisations.
Public servant/service	A term used to identify those who are employed by government-funded organisations. Some countries use both, "public servant" and "civil servant" when describing government-funded employees, with public servant having a broader application *(e.g.,* encompassing doctors, teachers, local government officials, etc.) than civil servant (*i.e.,* employees working in the central government).

Executive Summary

Since the restoration of independence in 1991, the government of Estonia has met the challenge of establishing a fully functional, stable, modern state. In this time, it has undergone a radical transformation from a centralised, planned economy and insular state to one of broad economic openness, solid democratic institutions, and integration with international political and economic institutions such as the EU.

Estonia has also demonstrated its capacity to respond quickly and agilely in times of societal crisis or great need. This has not only been demonstrated in its history, but also in its rapid and successful response to the global financial and economic crisis. In order to maintain this agility, however, the Estonian public administration needs to learn to work as a single government to design, implement and sustain the government's policy priorities and to help meet new challenges on the horizon. To do so, it will need to capitalise on its strengths, overcome structural challenges, and avoid rigidity in its working methods and structures. Thus, it has asked the OECD to evaluate its public governance and administrative structures, particularly as they impact performance, policy outcomes, and public service delivery.

Towards a single government approach

Estonia faces many of the same pressures as other OECD countries: escalating financial burden and workforce capacity issues due to an ageing population; high levels of unemployment as a result of the global financial and economic crisis; and territorial disparities. At the same time, its public administration operates within the context of a small state, where a variety of characteristics can influence the public governance and management choices Estonia makes in realising its ambitions. Given its small size and exposure to international trends, how can the public administration help the country grow in global competitiveness and national economic and socio-economic development?

While Estonia has enjoyed almost 20 years of growth, in the near future, public resources are likely to remain flat or decline (as in most other OECD countries). In such a context, Estonia needs to maximise limited human and financial resources by building innovative capacity and improving the flexibility and responsiveness of its public administration so that the different parts of the public sector – including the state and sub-national governments – can work as a single government to realise objectives and to prepare for new challenges.

Achieving a single government approach begins with developing a shared understanding of what it means to work in a "whole-of-government" way. This involves some changes in structures and legislation, but more importantly, it requires a change in organisational culture and individual expectations, enabled by reinforcing and guiding existing networks and leaders for the public administration to work in new ways. Developing a common agenda of societal goals and priorities for the government and for the public administration

clarifies why a single government approach is necessary and helps to build a dialogue between the public administration and society as a whole about what changes are needed and how to achieve them. Finally, achieving a single government approach that provides seamless services to citizens and business will require a wide spectrum of actors to work together in new and innovative ways; these partners include central and sub-national government, ministries and agencies, municipalities and counties, and external stakeholders in business and society.

Promoting a "whole-of-government" approach in public administration

A whole-of-government approach, where horizontal co-ordination and integration are embedded in the process of policy design and implementation, helps a government respond to complexity. Whole-of-government approaches can re-calibrate systems that have moved too far into sector-based silos, have become fragmented, or that suffer from poor co-ordination and co-operation. Such an approach, however, requires high-level guidance *(e.g.,* the Centre of Government operating in a stewardship role) to set expectations and ensure overall accountability, as well as cross-sectoral management, and cultural change.

Like most countries, Estonia has a hybrid governance structure, combining strong vertical silos and formal, legalistic arrangements with many personal and informal networks. Moving to a single government approach is a long-term process founded on political commitment and leadership that transcends party lines and individual electoral terms. In Estonia, both the formal and informal will need to be addressed in order to promote informal co-ordination and co-operation, while some processes and networks will need to become more institutionalised in order to improve sustainability of working methods and information management. In addition, mechanisms to strengthen co-ordination and co-operation in both the political and administrative spheres are needed. This can include strengthening and institutionalising networks at the Secretaries General and Deputy Secretaries General levels, building accountability mechanisms and ensuring greater communication regarding reform initiatives. A whole-of-government approach also applies to the management of the public administration itself where greater flexibility of staff and structures and improved co-ordination can help promote staff mobility and a whole-of-government understanding of tasks and roles.

Developing a common agenda

Identifying a common agenda that business and society can support provides a roadmap for achieving a single government approach. Building such an agenda will help Estonia's government balance its values with societal preferences, set objectives and priorities strategically, better understand the costs and benefits associated with specific policy programmes, and evaluate them consistently with agreed-upon objectives. In this way, the public administration can optimise the use of its resources.

Estonia's public administration functions on the basis of multiple strategic plans, many of which do not become operational. Given that 2013 marks the end of the current strategy planning period, Estonia's ministries and agencies have the opportunity to re-assess how they go about their planning and prioritisation, identify ways to build greater cross-sectoral

collaboration, and better integrate strategic and budgetary planning. To this end, Estonia is looking to strengthen the links between strategic planning and budget frameworks, and intends to develop its performance budgeting processes as a means to improve capacity for decision making, prioritisation and accountability. Enhancing its evidence-based decision-making capacity and building citizen engagement practices could strengthen Estonia's anticipative, innovative and adaptive capacity.

Delivering public services effectively

A single government approach can also strengthen public service delivery, particularly as services are delivered, either directly or indirectly, by all levels of government. Direct public service delivery by government is diminishing, as decentralisation together with alternative forms of public service delivery increase. While success in public service delivery is often thought of in terms of service effectiveness (including efficiency), improving service delivery may require placing greater weight on citizen satisfaction, rather than simply focusing on public administration needs and concerns. This, in turn, may have implications for how service delivery is structured and organised, including developing more consistent processes and approaches to service delivery and greater use of shared services.

Estonia faces a series of inter-connected challenges to delivering high-quality public services. At the central level, the government has begun to consolidate "back-office" operations for county governments, and to experiment with rationalising "front-office" activity by merging all local State representation into one physical working environment. At the local level, however, the lack of standards and performance measures, and the mismatch between fiscal capacity and devolved responsibilities put pressure on local government service capacity. Estonia needs to take an integrated and innovative perspective in developing solutions. This would entail tailoring service delivery requirements to population needs, matching service sets to municipal capacity, building scale, and linking action at the municipal level with a broader vision for territorial development and regional policy. Given the many elements involved, the central/sub-national relationship will need to be strengthened through greater institutional co-ordination and collaboration.

Case studies

This report includes two case studies that help to illustrate the need for working as a single government: one focusing on education, and the other on social services for the elderly. Both policy areas face service delivery challenges due to changing demographic contexts and municipal capacity, as well as governance needs that include vertical and horizontal co-ordination and co-operation.

Estonia places a high societal value on education, which is reflected in a number of international measures, including the OECD Programme for International Assessment (PISA) and the United Nations Global Human Development Index. There are concerns, however, that Estonia will need to do more to ensure that its education system sustains high quality and equity of outcomes, and that what students are learning is relevant to evolving social and economic needs across the country. These concerns include education funding, local government capacity, and overcoming resource scarcity through horizontal co-operation. In

some ways, this is a classic management dilemma – how to do more with less – but the debate also raises fundamental questions on governance of the education system.

European countries are rapidly ageing, and Estonia is not an exception. Estonia's elderly are one of the poorest and most vulnerable segments of the population, as health and social care expenditures are lower and reported health problems among the aged higher than in other European countries. Estonia's policy makers are confronted with how to organise the financing, provision, and regulation of social services for the elderly in the face of increasing demand. The challenges include finding adequate resources (both financial and human capital), clarifying government-provider relationships, co-ordinating with centrally funded health services, and improving knowledge of elderly care needs. At issue is improving outcomes for Estonia's elderly through more sustainable and co-ordinated delivery of services.

The inclusion of these two case studies, presented as individual chapters, evaluates these questions within the broader context of public governance in Estonia, including co-ordination mechanisms for a stronger whole-of-government approach.

Moving forward

Due to its small size, Estonia cannot afford to be fragmented. Developing a single government approach may become a key factor in its continued success as it matures in its statehood. Senior public administration officials seem open to making structures more flexible, improving communication, overcoming inter-ministerial/inter-agency barriers, making strategic planning more cross-sectoral, and matching implementation structures to issues rather than the other way around. Critical public administration reforms are needed, however, to give shape to this vision by providing the structural and legal means for greater flexibility; the data and indicators to underlie decision making, prioritisation and accountability; and the skills and capabilities to better lead the public administration, engage with society and to develop and embody a single government approach.

Chapter 1

Main Assessment and Key Recommendations

Overview

Since the restoration of independence in 1991, and prior to the global financial and economic crisis, Estonia enjoyed one of the most dynamic periods of economic growth among both transition and OECD countries. Critical to this success was Estonia's transformation from a centrally planned economy to a liberal market economy. The stewardship of the government has resulted in budget surpluses, a reasonable level of openness, and a high level of economic and political stability – an important factor for investors. As a result, the Estonian government, supported by the public administration, was a key orchestrator of economic development.

Over the same 20-year period, Estonia has also developed – practically from scratch – all the functions and apparatus of a modern state, including a legal code, a civil service, and national and sub-national institutions that bear all the responsibilities and risks of independent statehood. This process of state building has required the government to implement change and adjustments, and prioritise to find equilibrium between living within national means and preparing for risks and opportunities on the horizon. This can involve both policy choices *(e.g.,* protecting pensioners, families and teachers), and choices about investment in the administrative capacity of the public administration *(e.g.,* getting the right balance of numbers and skills, and building linkages across ministries and levels of government).

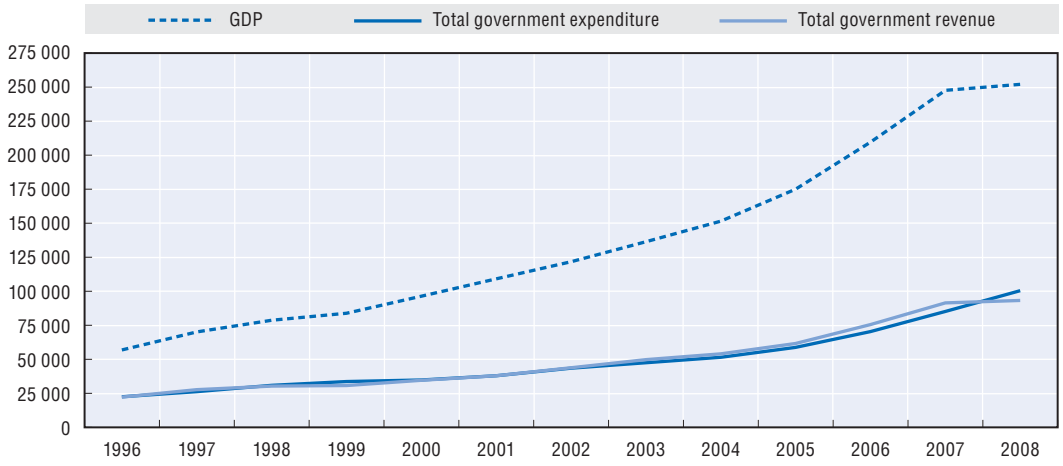
In addition to the current economic crisis, Estonia is now facing a number of new challenges, including demographic decline and growing regional disparities. Many positive developments – such as longer life spans, rising standards of living, and European integration – will also bring new challenges for the public administration. As Estonia matures, it will need to continue to take advantage of its small size to remain strategically agile and to make the most of its national assets. This requires a public administration that is fit for purpose in terms of carrying out the government's policy agenda, but also providing high-quality analysis and advice, ensuring that longer-term needs and perspectives are taken into account, and working as a single government in the service of citizens and business.

Fiscal stewardship has led to public budget surpluses and low public debt

After suffering a short recession in 1999, mostly related to the Russian financial crisis, Estonia experienced a period of strong economic growth between 2000 and 2007, with an average annual rate of real GDP growth of 8.3% (see Figure 1.1). During this period, the unemployment rate decreased by as much as 9 percentage points, from 13.8% in 2000 to 4.8% in 2007. Most importantly, Estonia ran a public budget surplus for five consecutive years, from 2002 to 2007, accumulating assets amounting to approximately 10% of GDP. Partly by using the accumulated assets, Estonia reduced its public debt, measured as general government gross consolidated debt, during the same period, from 5.1% in 2000 to 3.8% in 2007. This economic success led to Estonia being called the "Baltic Tiger".

Figure 1.1. **GDP, Government expenditure and revenue, 1996-2008**

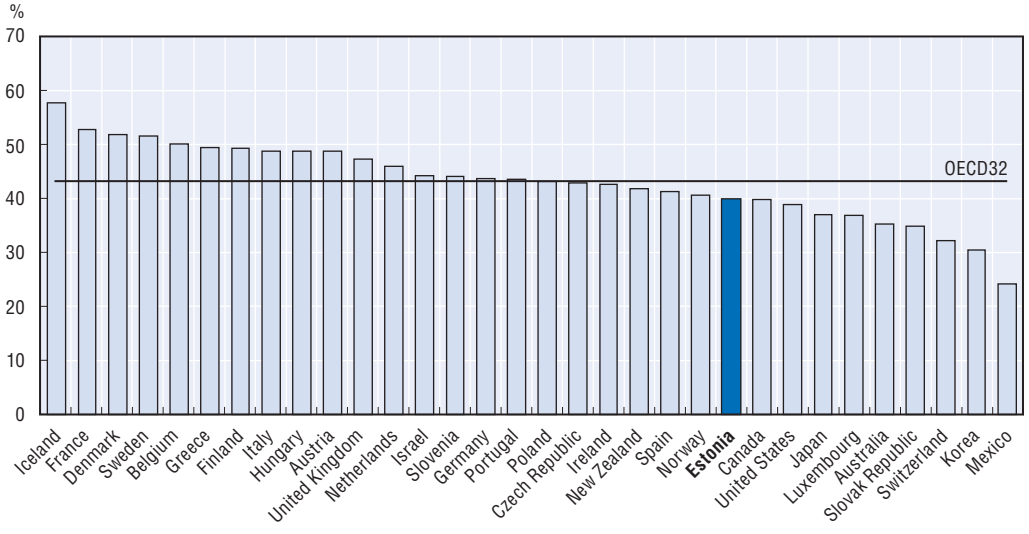
National currency, millions of kroons



Source: OECD (2010), *Statistical Database*.

Budget discipline has been achieved through policy prioritisation. Estonian public expenditure as a percentage of GDP is in the lower range compared to other OECD countries (see Figure 1.2). Estonia spends almost 10 percentage points less on social protection than the average for OECD-22 countries, in terms of percentage of GDP. However, the public sector still holds an important role in social cohesion, with the highest levels of public expenditure going towards social protection (29% of government expenditures), followed by education (17%) and health (13%) (see Figure 1.3). The share of public expenditure on education, economic affairs, and public order and safety are higher than in the group of 22 OECD countries.

Figure 1.2. **Public expenditure as a percentage of GDP,[1] 2008**



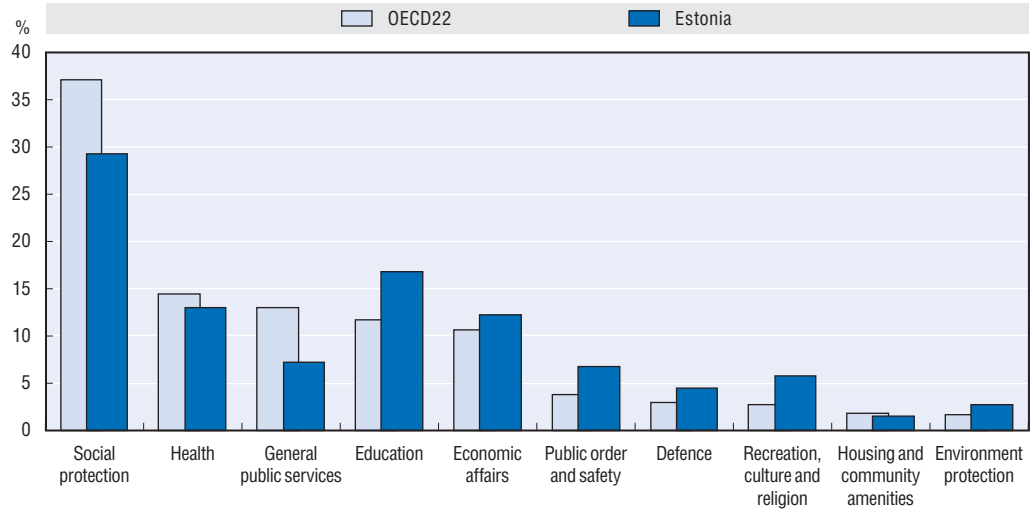
Note: Data are unavailable for Chile and Turkey.

1. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD (2010), *National Account Statistics*.

Figure 1.3. **Total government expenditure by function, 2008**

Percentage of total general government expenditure



Note: Data are unavailable for Australia, Canada, Chile, Israel, Japan, Mexico, New Zealand, Norway, Republic of Korea, Switzerland and Turkey from this data source.

Source: Eurostat Databases (2010).

These policy choices reflect, in part, traditional expectations about the role of the state (*versus* the family and community) for the care of the poor and the elderly. They also reflect current policy priorities, including competitiveness, cultural identity, national integrity, and the preparation of the future workforce. Within the area of social protection, for example, a larger proportion of social spending goes to family support policies than to elderly care.

By focusing on its objective of joining the European Monetary Union (EMU), Estonia was able to maintain its favourable budgetary position when it was hit by the global financial crisis. It is one of the very few countries that managed to keep a positive index when comparing 2009 levels of general government revenue and expenditure to 1995 levels (see Figure 1.4). By basing an index of 100 on the 1995 public budget fiscal balance (government revenue minus expenditure), Estonia achieved a positive index of 103 in 2009. The 24 OECD member countries for which data are available have a much lower average index, at 80.6 in 2009. Successive public budget surpluses helped Estonia fast-track EMU membership, while accumulated assets were used to reduce public debt, enabling Estonia to move rapidly out of recession. It also increased the credibility of its financial markets by attracting foreign investments.

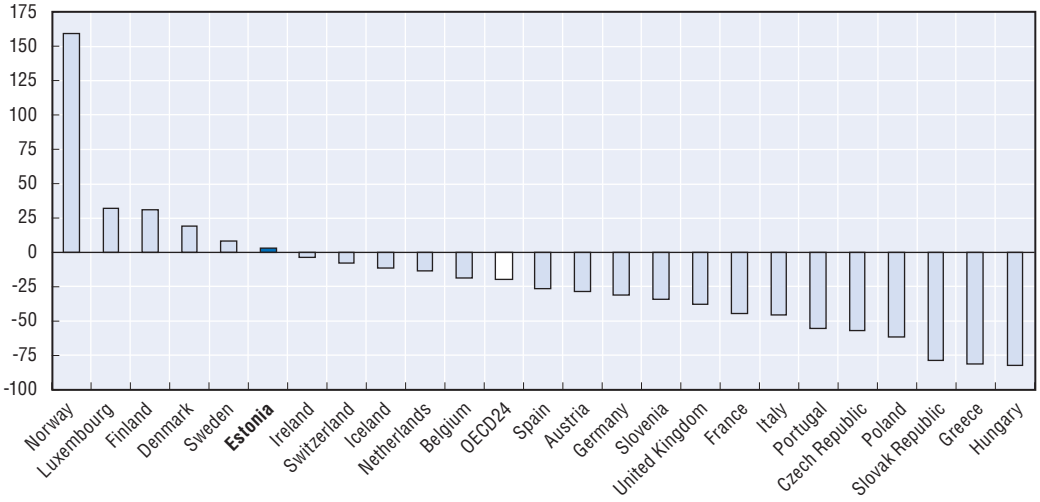
Entering into the global economic crisis in 2009, Estonia's level of public debt (according to the Maastricht criteria) was lower than any other OECD-EU member country. Public debt represented 7.2% of GDP, compared to an average of 60.2% for the 22 OECD-EU member countries. However, Estonia experienced the fourth largest increase in public debt between the eve of the global financial and economic crisis in 2007 and 2009, with a 90.4% increase in nominal terms. In addition, Estonia's level of private debt remains significantly higher than its public debt.

New challenges on the horizon

In addition to the current economic situation, Estonia faces an escalating financial burden and critical workforce capacity issues as a result of a decreasing and ageing

Figure 1.4. **Public budget balance: Difference between 1995 and 2009**

1995 = 100 index



Notes: The index was calculated by adding the differences between government revenue and expenditure as % of GDP from 1995 to 2009. Data from this source are not available for Australia, Canada, Chile, Israel, Japan, Korea, Mexico, New Zealand, Turkey and the United States.

Source: Eurostat Databases (2010), OECD calculations.

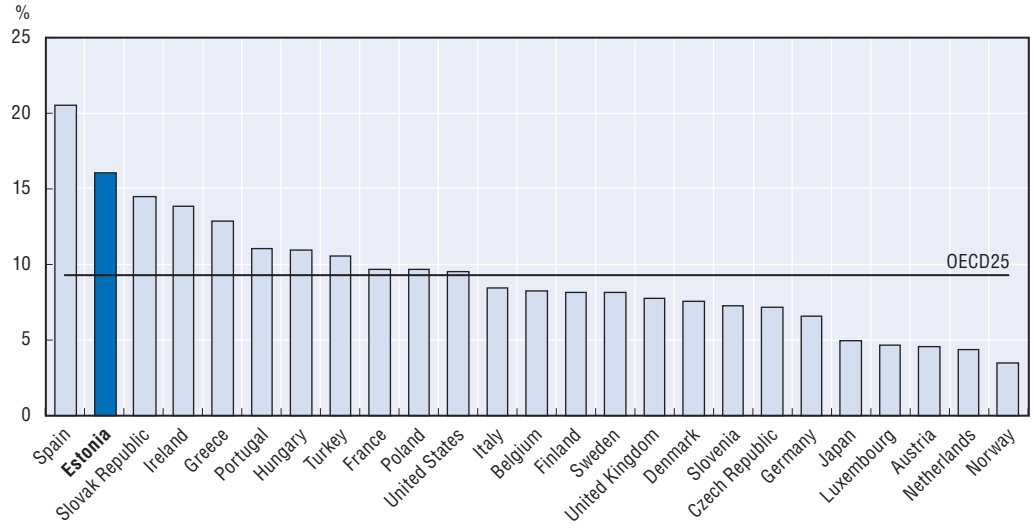
population, and also due to the current high level of unemployment. New challenges are arising from a geographic standpoint as well, including a shift in centres of economic productivity and a related concurrent re-distribution of tax bases.

Over the last 15 years, Estonia's overall population has decreased by 7%, from 1.44 million in 1995 to 1.34 million in 2009. The population is expected to decline further, to approximately 1.2 million people in 2050. The main reasons for this decrease are negative net migration (which has evened somewhat in the last three years), and a low birth rate (which, while on the rise, remains low). Furthermore, in terms of the age structure of the population, Estonia's dependency ratio[1] will increase faster than the OECD average over the next 15 years. Indeed, although the share of the working-age population[2] has increased by 3.2% since 1995, it is expected to have decreased by over 8.5% by 2025. The result will be one of growing pressure on the provision of social benefits to citizens, stemming from increasing demand for social and health care services for the aged on one hand and a tax base that is static at best but likely to shrink given demographic trends on the other.

Even as public service needs are growing, the global financial and economic crisis has forced the central government to cut municipal revenues and restrict municipalities' borrowing rights in order to keep the overall public sector on the desired path. It is estimated that the result of the recent cut in the income tax re-distribution rate (from 11.93% to 11.4% as a result of crisis-induced austerity measures) equated to a revenue reduction of approximately EEK 300 million (EUR 19 million) for municipalities in 2009, which amounts to 2.2% of total local government revenues. The actual income of local authorities in the first eight months of 2009 dropped to 89% of the level for the same period in the previous year. This can be explained by an increase in unemployment rates from 6.5% in February 2009 to 11.2% at the end of August 2009. In addition, it is estimated that the increase in the VAT from 18% to 20%, together with other tax increases, will place an additional burden of EEK 200 million (EUR 12 million) on local budgets.

As in Ireland and Finland – other examples of small and open economies – market openness has been responsible for the high level of competitiveness of the economy, but also for vulnerability when the crisis hit. Prior to the global financial and economic crisis, unemployment in Estonia was relatively low. As of September 2010, however, Estonia has the second highest level of unemployment among OECD countries at 16.1% (see Figure 1.5). Post-crisis, there are fears that the economy will face structural unemployment. Eighty per cent of individuals newly unemployed due to the global financial and economic crisis originated from the construction and manufacturing sectors, and significant labour market rigidities within those sectors will prevent mobility towards other growing sectors. If unemployment becomes structural, Estonia will experience even greater pressure on its social benefit capacity, particularly with respect to unemployment, professional training or retraining, and education.

Figure 1.5. **Unemployment rate, September 2010**



Note: Data from this source are not available for Australia, Canada, Chile, Iceland, Israel, Korea, Mexico, New Zealand and Switzerland.

Source: Eurostat Databases (2010).

Looking ahead: Preparing the public service for future challenges

Thus far, the Government of Estonia has been quite effective in state building, meeting immediate objectives, and establishing itself as a model for small, open economies. It appears to be at a crossroads, however – a young democracy that needs to take stock of where it currently stands, and where it wants to go. In doing so, it faces such questions as: Is its public administration well positioned with sufficient capacity to respond rapidly to risk? How can the public administration help Estonia become stronger, both in terms of global competitiveness and its own economic and socio-economic development? How can it better anticipate and respond flexibly to upcoming challenges? Finally, due to its small size, Estonia cannot afford to be fragmented. How can its government act as a single government to efficiently provide seamless and high-quality services to its citizens and businesses?

An efficient, effective, accountable and transparent public administration can boost legitimacy, trust and commitment to a country's economic and political reform agendas, as well as improve the quality of policy design and implementation. However, public sector

reforms are often complex, unpopular, contested and risky. They require time to produce results and prove their benefit. Many public administration leaders in Estonia are aware of these challenges and have sought to put measures in place to shore up the public administration's capacity to meet current and future needs. Reforms currently underway or being considered at the central level include:

- programme and accrual budgeting (led by the Ministry of Finance);
- shared support (HRM and accounting) services (led by the Ministry of Finance);
- civil service reform (led jointly by the Ministries of Finance and Justice); and
- better regulation (led by the Ministry of Justice).

Of these reforms, however, only the Shared Support Services initiative has received political backing. As of the writing of this report, the implementation of Shared Support Services is well underway (it does not need any additional legal authority), while the civil service reform seems to have stalled in Parliament.

The Ministry of Finance is now piloting a new programme and accrual budgeting initiative in order to demonstrate the associated expected benefits and to provide a plan for meeting implementation challenges associated with such reforms (the Government turned down a similar proposal in 2008). The Better Regulation reform is stalled; the Cabinet decided to consult with Parliament before holding its final discussion, but the measure has not moved past the Parliamentary discussion phase. There is a possibility that it may be advanced simply on administrative authority.

The apparent ambivalence of politicians and administrative leaders regarding reforms seems to reveal a lack of shared understanding about the role of the public administration for ensuring Estonia's future. Coupled with a sound financial system, the government's ability to re-prioritise and re-deploy its resources leading into and during the global financial and economic crisis allowed Estonia's economy to do far better than many other OECD countries. This shows that in a crisis situation, Estonia has the ability to adapt rapidly and effectively to a changing global environment. Part of this strategic agility is due to the small size of the public administration and of the group of political and administrative decision makers. Both the benefits and risks of this structure should be taken into account as Estonia seeks to capitalise on its advantages and prepare for future challenges.

Promoting a whole-of-government approach in public administration

Building a whole-of-government approach to public administration and policy is a long-term endeavour that requires political commitment and leadership that transcends party lines and individual electoral terms. Such commitment is illustrated by Finland, which has consistently and systematically benefited from a steady and long-term plan to move towards a whole-of-government approach, *e.g.*, through use of its Government Programme. It also requires a systematic and institutionalised approach rather than one driven by personalism.[3] However, a "top-down" or "mandated" initiative to introduce whole-of-government working may not be successful. Cultural change is required within the public administration at all levels of government. This includes cultural change as applied to processes and attitudes. Among countries that are moving towards whole-of-government approaches in their public administrations *(e.g.,* Australia, Canada, the Netherlands, New Zealand, Sweden, and the United Kingdom), there is growing focus on a strong and unified value set, trust, value-based management, collaboration, team building, involvement of outside stakeholders, and improved capacity (training and self development) of public servants.

A single government approach is closely linked to institutionalised support mechanisms *(e.g.,* stewardship by the Centre, tighter financial management, and stronger governance and accountability frameworks). At the service interface, these can be "one-stop shops", such as Lääne County's State House initiative. Behind the scenes, it includes consolidated back-office activities, related services, and IT systems. Estonia's recent consolidation of its accounting and personnel functions through its Shared Support Services programme is a step that can reinforce single government functionality. By bringing support staff together on the one hand, and streamlining ministries on the other, it can also help to promote necessary cultural change. Additionally, more effective (and efficient) inter-government services can be fostered. For example, real estate services – including building management, maintenance, and transactions – are being considered and managed as a discrete silo. Finally, IT development and support is critical to helping all the branches of government work in a joined-up, collaborative fashion. Multiple and different platforms and functionalities can work against a single approach. Thus, shared data, systems and processes help make a whole-of-government approach operational.

Estonia has shown its capacity to work in a joined-up fashion in its response to the global economic and financial crisis, particularly at the political level within the Cabinet (see Box 1.1). However, it has yet to transform this into an every-day mode of operation, which would mean ensuring this ability outside of crisis situations, and making it part of the administrative culture. Horizontality in Estonia rests strongly on informal networks and practices. This characteristic of small states can be very effective, especially in times of crisis, but it has some inherent weaknesses. Moving towards a single government approach to public administration and service delivery means building on existing strengths *(e.g.,* informality, flexibility, responsiveness), while shoring up weaknesses *(e.g.,* individual conflicts, inertia, *ad hoc* processes). In Estonia this will require:

1. promoting co-ordination, co-operation and collaboration in the public administration;
2. creating a supporting organisational culture;
3. building a flexible public administration;
4. taking a whole-of-government approach to the state public administration.

Box 1.1. **Responding to the global financial and economic crisis at the Cabinet level in Estonia**

In responding to the global financial and economic crisis, the Cabinet of ministers took an active interest in managing the budget process. The Cabinet met to discuss the 2009 budget in 37 meetings, 22 of which took place in 2009. In total, members of the Cabinet spent three full working weeks collaborating on the details of the austerity budget. Budget negotiations took place at two levels: among public servants, and then at the ministerial level. Regular meetings also took place among financial managers to clarify the position of the state's finances.

Source: Ministry of Finance of Estonia.

Promoting co-ordination, co-operation and collaboration in the public administration

Estonia operates a fragmented and decentralised public administration. However, as a small state, it is critical that the public administration work as one cohesive unit, rather than in separated silos. The ability of actors within the public administration to co-operate and collaborate in a co-ordinated fashion will be a key step in achieving a single-government approach (see Box 1.2). This applies to collaboration across ministries, between ministries and agencies, among agencies, and with sub-national partners.

Box 1.2. **Co-ordination, co-operation, collaboration: A definition of terms**

Co-ordination: Joint or shared information insured by information flows among organisations. "Co-ordination" implies a particular architecture in the relationship between organisations (either *centralised* or *peer-to-peer,* and either *direct* or *indirect*), but not how the information is used.

Co-operation: Joint intent on the part of individual organisations. "Co-operation" implies joint action, but does not address the organisations' relationships with one another.

Collaboration: Co-operation (joint intent) together with direct peer-to-peer communication among organisations. "Collaboration" implies both joint action and a structured relationship among organisations.

Source: OECD (2005), *e-Government for Better Government,* OECD, Paris.

Estonia's public administration has shown its capacity for horizontal working at both the political and administrative levels. However, this ability to come together collectively shines more in times of crisis, or when a more immediate policy response is needed, than in "business-as-usual" activities.

At the administrative level, power is decentralised. Ministries assume responsibility for the policies and programmes within their own sector portfolios (reinforced through budget and strategic planning frameworks), but there are also many examples of the centre (the Government Office and the Ministry of Finance) successfully leading change in a horizontal fashion (*e.g.,* on pensions and shared services). The Ministry of Finance has the most direct leverage over the central and sub-national levels in its role as the "keeper" of the budget. The Government Office has a less direct, but no less important, role in terms of convening actors, initiating dialogue and communicating policy priorities and successes. It has divested some of its operational responsibilities to the Ministry of Finance (*e.g.,* for workforce development), as well as to the Ministry of Justice (*e.g.,* the publication of the official journal) and to the Ministry of Education and Research (*e.g.,* the public archives) in order to focus on a stewardship role in which it steers and provides oversight of the public administration. However, to be successful it needs to maintain linkages to the ministries, not just through the Cabinet process but also via the public administration, by reinforcing mechanisms that promote co-ordination, collaboration and co-operation across the public administration. This will require maintaining a sustained and closely aligned partnership with the Ministry of Finance, as well as maintaining some of its own analytical capacity for strategic planning.

Mechanisms to promote co-ordination at the central level

Estonia has an impressive ability to establish working groups for a variety of activities including pilot projects in the public administration, drafting policy reforms and legislation

(e.g., the Employment Contract Law), processes and systems *(e.g.,* sustainable development indicators), sub-national negotiations, and international initiatives. Often these are populated with a wide array of appropriate stakeholders, providing a more structured way to tap into individual personal or professional networks, both inside and outside of government. It is important to ensure, however, that networks do not become "exclusive" and that they remain open to voices of dissent. One of the responsibilities of working groups as a co-ordination mechanism is precisely to listen to a variety of perspectives, synthesise these, apply them as appropriate to create stronger and more sustainable results, and then move forward with the initiative.

In Estonia, there also is solid co-operation and collaboration at the technical or administrative level, often based on or reinforced by informal networks and personal relationships. This is evidenced by the collaboration required for designing and implementing pilot projects and integrated (cross-sectoral) policy initiatives *(e.g.,* the programme and accrual budgeting initiative, the Employment Contract Law). In and of themselves, informal networks are highly positive. They facilitate an exchange of ideas and knowledge that can enhance innovation capacity. They are also sources of information and are dynamic, creating links to a diverse set of entities – be they individuals, organisations or institutions. However, dependence on such networks *versus* more institutionalised mechanisms reduces accountability and transparency of decision making.

In the aggregate, individual networks are only as strong and beneficial to an institution as the tenure of the person with which they are associated. Thus, they are easily fragmented if relationships break, either within the network or between the individual and the organisation. This puts greater weight on informal structures, which can prevent some important networks from being embedded in organisational working methods and lead to weakened governance structures.

One way to minimise the risks associated with heavy reliance on informal networks and to enhance collaboration and co-operation is to complement the use of informal personal networks with institutional networks. This entails embedding networks more formally in the administrative culture. In Estonia, such activity is beginning in the EU Secretariat of the Government Office. Institutionalised networks are a means to build an organisation's social capital, where ties are formed between the institution and government bodies, civil society groups, thought leaders, individuals, etc. Links within and among institutionalised networks are maintained even when individuals leave the organisation. The EU Secretariat's success in effectively co-ordinating EU affairs policy and building collaboration and co-operation with relevant ministries should be used as an example in other priority policy areas within the public administration.

With cross-sectoral policies (those that cut across the functional responsibility of a number of ministries or departments), it can be difficult to determine who is the overarching leader of the initiative. This can make accountability vague, a challenge associated with whole-of-government systems. Inter-departmental or cross-functional committees can help clarify accountability, and also ensure coherence and strategic integration in priority policy areas. In Estonia many cross-sectoral working bodies have been established, in the form of groups, committees, councils, etc.; the ability to establish such co-ordination mechanisms is clearly present. What is less evident in Estonia is the ability to formally sustain groups or their work over time. Inter-ministerial groups for cross-sectoral initiatives do not have to be indefinitely established. They can remain *ad hoc*,

composed for the purpose of a specific policy initiative; but care should be taken that for the period of their lifetime there are formal co-ordination mechanisms associated with their activities. This can include holding regular meetings, establishing and circulating agendas, and disseminating the outcomes and decisions taken in a meeting to group members (and possibly other stakeholders when appropriate) in a written format. Another advantage to written communication is that it helps establish a group understanding of the decisions taken, as well as any associated activities and responsibilities for action.

Creating a supporting organisational culture

Organisational culture is linked to the success of a whole-of-government approach. Many of the complex issues facing Estonia now and into the future transcend traditional boundaries. Given the strength of informal networks in Estonia, promoting a networked and horizontal organisational culture among public sector organisations involves reducing silo mentalities and putting these networks at the service of overall government objectives. This can be achieved through effective leadership; building public service values; and strengthening accountability and incentives.

Supporting a whole-of-government approach through effective leadership

Collaboration and co-operation among senior leaders is critical to achieving a whole-of-government approach to public administration. One reason that public administration reforms have not advanced in Estonia is that senior public servants have not been able to articulate a coherent and unified message about the need and direction for reform, and then communicate it to politicians. Given conflicting signals, politicians have held off committing to public administration reforms. To gain support and buy-in at the political level, the public administration's senior leadership needs to communicate its own vision for reform. This requires leaders across the public administration to collaborate in developing a co-ordinated vision or direction for where the public administration should be heading, or for the type of reform necessary, before going forward to government.

In a small state such as Estonia, over-reliance on individual, personal networks with strong emphasis on the exercise of informal authority can allow individuals to exert heavy and direct influence on the system. They are also more likely to be personally identified with actions and their results, both positive and negative. Given the pressure this can cause, the result can be an avoidance of decision making, taking the form of delegation up and/or down. Decision making and policy implementation can also be subject to strong personalities, who can stall or neutralise any forward movement if they do not agree with a proposed action. This can leave institutions that have "weak" heads with even less influence. The result is a situation where any one person can be the locus of any system dynamic, which can lead to a problem of accountability (particularly in the long term).

Cultural change in support of a whole-of-government approach requires leadership by example. At the administrative level in Estonia this should begin with the Secretaries General (SG), starting with their established Monday meetings. Currently, participants at these meetings work through administrative issues associated with the agenda brought forward for the Thursday Government meetings. However, such meetings could also present an opportunity for building a strong network that can promote and communicate complex reform across the government, within line ministries, and to relevant internal and external stakeholders. As a defined senior network of peers, the SGs are ideally placed to build shared responsibility, promote inter-ministerial co-operation and collaboration, and

to build and strengthen links to leadership. Such groups could also be emulated at the level of the Deputy Secretaries General (who currently do not have an established formalised network), as in Japan, and also at the Department Head level. This serves to deepen collective ways of working at all levels, to broaden communication channels, and to prepare the next generation of senior leaders.

High-level inter-ministerial groups can create a sense of ownership and responsibility for a policy among relevant SGs, and solidify leadership and accountability. They can also strengthen the shared values set and build trust among potentially divergent interests. Of course, establishing an effective group requires time, practice and capacity. Commitment from the public administration's senior leadership is required to exert the competencies needed to achieve a whole-of-government approach. In May 2005, the Government Office introduced the Competency Framework of Estonian Senior Civil Service as a tool to support the selection and development of senior executives, in order to ensure achievement of the state's strategic objectives. The key criteria of the competency framework include: credibility; a strong vision; innovation; leadership; and outcome orientation. This competency framework is applied to the selection, assessment and development of senior leaders,[4] whose participation is voluntary – approximately 65% of senior leaders are participating in the programme. Over time, Estonia should consider adapting the competency framework to other major staffing categories *(e.g.,* middle management) in the public administration and build incentives through performance assessments to motivate participation.

Finally, there is a political consideration as well: the behaviour and role of SGs is at least partially linked to the expectations of ministers. Thus, if ministers expect SGs to perform and act in a co-ordinated manner, promote collaboration, and facilitate co-ordination across ministries, they can help create an enabling environment. However, if ministers themselves reinforce silos, are reluctant to share information, and have difficulty making their objectives clear, this impedes more dynamic and effective interaction at the SG level. In particular, working as a single government requires Cabinet consensus and clear room for the public administration to build the administrative platform to deliver on horizontal political objectives. Clear expectations and delineation of responsibilities between the political and administrative levels could help manage this. Given their position, politicians are well placed to focus on overall policy objectives and outcomes (the "what"), while the public administration is well placed to focus on policy instruments and implementation (the "how"). A clearer separation of functions would continue to permit agenda setting and prioritisation by the political level, while allowing the civil service to lead and develop public administration reforms, such as performance management systems, across electoral cycles.

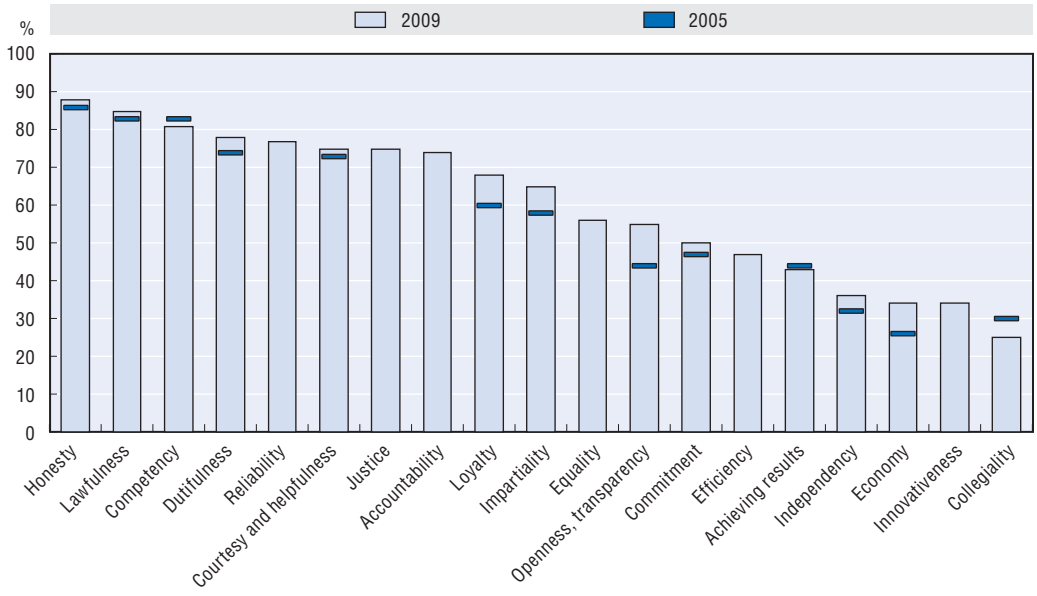
Public service values and capabilities

Public service values are critical to establishing a whole-of-government approach to public administration. Values reflect what the public service is trying to achieve, and lead to the design of collective and individual objectives, and maintenance of the collective public service culture. In decentralised public administration systems, like Estonia, public service values can help to embed a culture where all actors in the public administration are working towards the same goals. The creation of a single public sector identity can only be achieved if public service values are aligned across organisations.

While informal networks are commonly used as a mechanism for collaboration and co-operation in Estonia, a *Survey of Roles and Attitudes in Estonian Public Service* found that only 25% of staff surveyed considered the value of "collegiality" as "very important" (down

from 30% in 2005). Interestingly, the percentage of staff surveyed that valued "independence" as "very important" increased to 36% in 2009 from 32% in 2005 (see Figure 1.6). These results highlight the importance of regularly reinforcing values of collaboration and co-operation as fundamental principles for working.

Figure 1.6. **Values in Estonian Public Service, 2005 and 2009**



Note: Values of reliability, justice, accountability, equality, efficiency and innovativeness were not surveyed in 2005.
Source: Government Office (2009), *The Roles and Attitudes of the Public Service,* Republic of Estonia, Tallinn (only available in Estonian).

Public service values tend to be enshrined in the legislation that applies to the public service, or in Constitutions, supported by codes of conduct and protected by administrative procedures and sanctions. In Estonia, under the *Public Service Act* (Section 59), a public servant shall perform their duties pursuant to the public service code of ethics and other codes of ethics established with their administrative agencies. Thus, while there is a very broad set of public sector ethical values prescribed by law, in addition to these, individual public sector organisations are free to develop their own. However, even in decentralised public administrations, governments typically still want to maintain a set of shared values and common structures and processes, and these need to be managed from the centre.

The 2009 *Survey of Roles and Attitudes in Estonian Public Service* found that awareness of codes of ethics is low, and that the need for ethics training has increased. In many OECD countries, the code of ethical values forms a key part of the public administration's organisational culture. It is suggested that the Public Administration Department in the Ministry of Finance undertake a communication campaign to raise awareness of the code of ethics and develop mechanisms for embedding the principles of the code into organisational culture across the whole of the public administration and at all levels of government. Estonia could look to countries such as Australia, New Zealand, Switzerland and the United Kingdom for examples of how to integrate public service ethics as part of organisational culture. Specific practical examples include linking codes of ethics to

recruitment selection criteria, individual performance assessments, leadership frameworks, training, and communication products.

Introducing accountability and incentives

A single government approach to public administration can also be reinforced through the use of individual staff performance management systems which link to the achievement of organisational and whole-of-government objectives and outcomes. Such systems provide a valuable mechanism for aligning organisational and individual incentives with overall government objectives. Performance measurement systems also aid in establishing accountability and incentives. Stronger personal incentives are needed to link individual outputs to the collective achievement of government outcomes.

Robust performance management practices can help to overcome the influence of any one individual in a system, and to focus individuals on achieving collective goals. Incentive mechanisms, such as individual performance management, are not embedded in the Estonian public administration. The Ministry of Finance is aware of this and is in the process of developing and piloting performance management proposals for the public administration. However, at this stage, there is no approved whole-of-public-service approach to the implementation of an individual staff performance management system. The Ministry of Finance efforts, if accepted by government, would introduce a performance budgeting framework for use as part of budget preparation, negotiations and decision making.

Currently, there is sporadic use of individual performance management systems in public sector organisations, with varying degrees of effectiveness. In order to align the government's objectives with organisational and individual incentives, as well as with collective achievement of government outcomes, effective individual performance management systems must be used and linked to broader performance budgeting and strategic planning frameworks. Estonia should look to implement a coherent individual performance management system across the public administration regardless of staff or official level (while allowing for tailoring within the decentralised system). Countries such as Australia, Denmark, Finland, Germany and Sweden, which have embedded the use of individual staff performance management systems into the culture of the public administration, are strong examples. Developing and establishing an individual staff performance management system in Estonia may take some time, and should be linked to consideration of the implementation of wider performance budgeting reforms (but can be implemented separately).

Building a flexible public administration

In order to adapt to the changing and increasingly complex policy environment, the public administration needs the flexibility to place its resources where they will best meet the needs of the government. By viewing itself as one entity – rather than many individual silo-ed public sector organisations – Estonia's public administration could achieve greater flexibility in the placement of human resources. It also needs the legislative authority to support a more flexible way of working.

The Estonian state public administration runs a decentralised and fragmented human resource (HR) system. HR is decentralised in ministries, with responsibility devolved to individual ministers. Each ministry is responsible for the HR arrangements within its organisation (directly accountable to each individual minister). In such a fragmented system, it is critical to have a strategic vision for the role of the public administration and for overall

personnel management. Such a vision does not exist in Estonia, despite the Ministry of Finance's responsibility for overall HR co-ordination within the public administration. Such activity may develop over time, as these responsibilities were only recently consolidated in the Ministry of Finance. Strengthening the State Administration and Civil Service Department within the Ministry of Finance, and giving it authority to co-ordinate efforts to build a whole-of-service vision, would facilitate management of the administration.

A more unified and mobile workforce contributes to achieving greater flexibility of the public sector's human resources. Under existing arrangements, ministers have responsibility for the human resources within their sector portfolios. This means that the public administration does not have total autonomy to manage its human resources independently of political leaders, and its ability to place its human resources to match needs/demand is inhibited. Responsibility for the management of public sector organisations could be officially devolved from ministers to heads of ministries/agencies/inspectorates, etc. (this would require amendment of the *Government of the Republic Act*). Estonia could look at arrangements in Sweden, where the government has transferred many of the employers' responsibilities to this level.

Devolving responsibility for human resources to the public administration allows the leadership to establish more collaborative working mechanisms based on emerging government priorities. Rather than creating rigid policy units that move between departments depending on the issue, a more flexible option is to use taskforces to address complex or urgent developments in policy or service delivery that cut across many parts of government, or to manage significant discrete projects or events. A more mobile public service culture also makes it easier to temporarily take staff from various ministries and agencies to work as part of a taskforce to develop a strategic policy or to prepare a strategic policy initiative for implementation. Such a "SWAT team" concept is also very useful in times of crisis or natural disaster. As the central body responsible for policy co-ordination, the Government Office is in a unique position to be able to convene a taskforce by drawing in expert staff from relevant ministries, agencies or institutional bodies to temporarily work on an issue. Taskforces should only be utilised for a short period of time, and the work handed over to a responsible ministry for implementation and long-term maintenance. This way of working should be supported and balanced by introducing greater co-ordination and conditions for mobility and stronger employer branding for the public administration.

While the public administration needs the ability to move staff in order to meet the changing needs of government, the government also requires greater flexibility to instigate machinery of government changes in organisations or functions (also known as administrative re-arrangements). There is very limited ability to do so under the current *Government of the Republic Act*. It is suggested that the *Government of the Republic Act* be modified to better enable incoming governments to re-arrange public sector organisations or their functions as needed to best deliver the government's programme for its term of service. However, to make this flexibility successful, the public administration needs to become more mobile and comfortable with a joined-up way of working. In addition, opening the public administration to more responsive machinery of government changes would require the establishment of an implementation handbook (similar to that used in Australia). In addition, Estonia could look to arrangements in New Zealand, where the State Services Commissioner is empowered to review the machinery of government across all areas.

Taking a whole-of-government approach to the state public administration

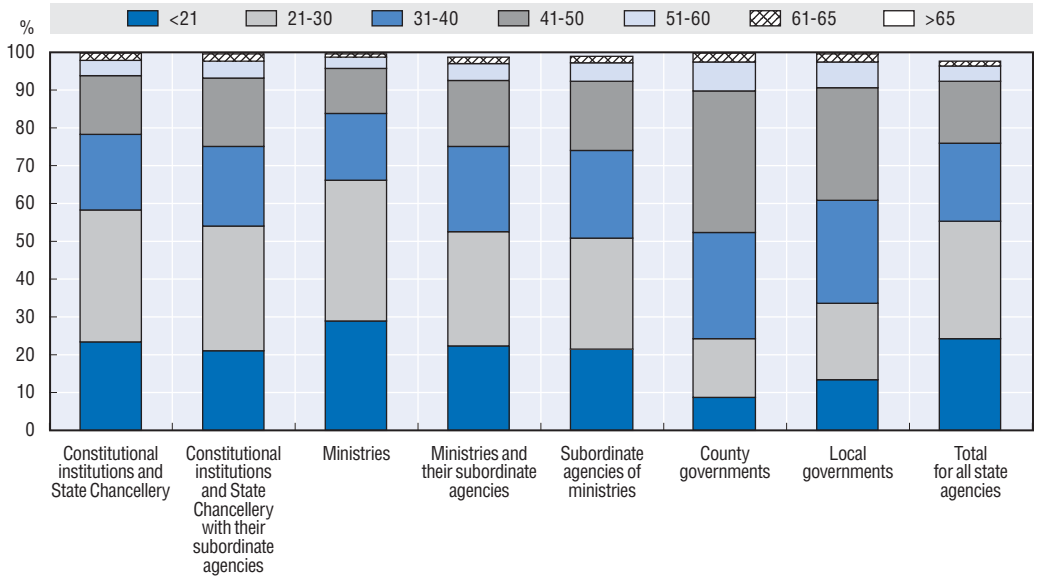
In small states such as Estonia, the public administration must make the most of the human resources it employs to ensure that workers are in positions which maximise the use of their skills and experience, and which will also be most effective in responding to the government's needs.[5]

There is no employer branding of the public administration, and little planning on how to attract the best graduates and talent into the public administration. This is particularly critical for Estonia, which given its size, has a small pool of experienced workers from which to recruit staff. The fragmentation and lack of strategic vision for HR across the public administration means that there is no whole-of-service focus on workforce planning. Workforce planning, when it does occur, is silo-ed and portfolio-based.

A significant leadership gap will be created when the current leadership cohort retires in 20 to 30 years (see Figure 1.7). This is due to significant hiring of new (and younger) staff after re-independence in 1991. The largest group of officials employed in the public administration are aged 31-40 years (31.2%) and aged 21-30 years (24.4%). While an ageing public administration workforce is not an immediate concern, recruitment strategies should be mindful to ensure that Estonia does not lead itself into a situation in the future where it may lose a large proportion of its workforce due to retirement, as is about to occur in Finland.

Figure 1.7. **Distribution of officials by age as of 31 December 2009**

In percentage



Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

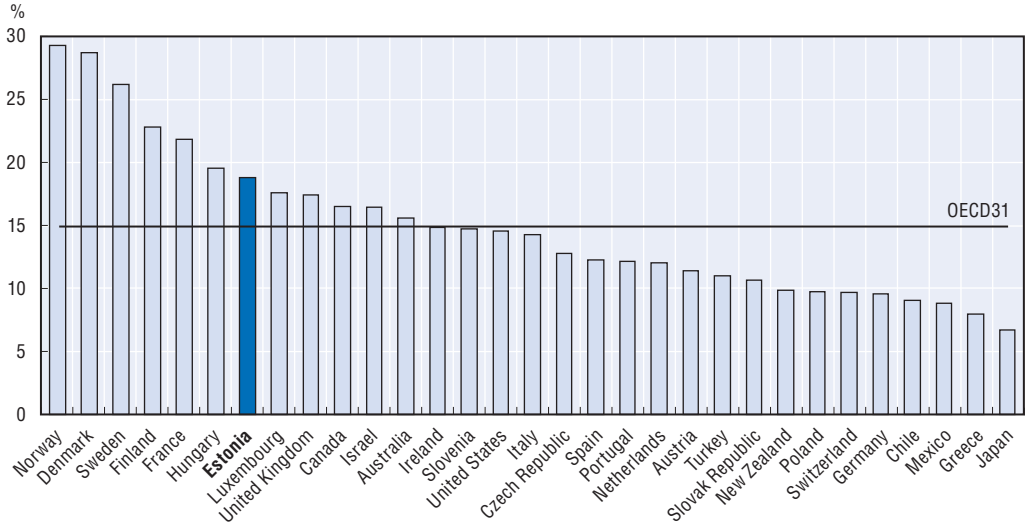
Currently, few formal mechanisms or institutionalised networks exist to guide the next generation and to assure the continuity of the public administration. The current structure *de facto* requires that individuals remain in their positions, particularly where success depends either on personalism, or on a well-developed network of personal relationships, or both. This works against the broader goal of a more agile and mobile public administration. Workforce planning across the whole-of-the-public-administration will be critical to effectively managing the age profile of those working in the public

administration. The existing succession management programme (the Newton Programme) should be expanded to include possible future leaders, and not just those identified as being immediate replacements.

The general government employment rate in Estonia is comparable to other OECD countries (see Figure 1.8). However, despite apparent government capacity based on numbers, the public administration does lack capability in some areas. These include strategic thinking, analytical capacity, management and leadership training, innovation and entrepreneurialism, and citizen engagement. Given the devolved responsibility for HR to ministers, staff training is a task for the HR units in individual ministries and agencies, etc. However, the central public administration department in the Ministry of Finance is responsible for providing horizontal training. Consideration needs to be given to how much is spent on training, as well as what training is given and how it is delivered. Due to the global financial and economic crisis, the training and development budget has been significantly decreased, dropping by 47.7% in 2009; this is a concern. Current priority areas for horizontal training include ethics and core values; improving policy-making skills; providing high-quality public services; Estonian language; and personnel management and other support services. In order to maximise the use of training opportunities, senior management within organisations must support the need for training and release staff to participate in training. Training needs should be identified in individual employee development plans, and these requirements should be mapped across the organisation. Employee development is a continuous process, where individuals and well as managers

Figure 1.8. **Employment in general government, 2008**

As a percentage of the labour force



Notes: Source: International Labour Organization (ILO), *LabourSta database*. Data for Turkey are from the Ministry of Finance and the Turkish Statistical Institute.
Japan: source of the employment data is Establishment and Enterprise Census. Employment is not classified according to SNA definition i.e. activity (market/non-market) and control by the government but status of employers as legal entities. The figure for employment in general government is substituted by direct employment by national or local governments instead of employment in general government.
Data for Australia, Chile and United States refer to the public sector (general government and public corporations).
Data for Austria, Czech Republic, Italy, Netherlands New Zealand and Poland are expressed in full time equivalent employment. Finland, Israel, Mexico, Poland and Sweden: 2007 instead of 2008.
France, Japan, New Zealand and Portugal: 2006 instead of 2008.

Source: OECD (2011b, forthcoming), based on preliminary data from *Government at a Glance 2011*, OECD, Paris.

need to be responsible for identifying training needs and matching these to appropriate training opportunities. Training can include formal courses, in-house training, mentoring, on-the-job training, rotation schemes, work experience, secondments, etc.

Mobility of staff within and across organisations in the public administration is a good tool to help establish a whole-of-government approach. Staff members who experience different roles, responsibilities, work content and organisational environments are more likely to think beyond the scope of their immediate responsibilities and have a better appreciation for how different aspects of the public administration fit into the broader picture. The culture of Estonia's public administration works against movement of staff. Staff currently view themselves as working for a particular public sector organisation, and are hired based on technical specialisation rather than generic policy skills; it is therefore difficult to encourage staff to move to other sector portfolios. The system would benefit from the implementation of rotation and secondment schemes for use at all levels within the public administration to encourage staff mobility within and between public sector organisations, and to and from the private sector, not-for-profit and international organisations.

Greater transparency of salaries and working conditions across the public administration can improve staff mobility. In Estonia, decentralised HR has also created differences in working conditions and remuneration across the public administration. The current *Public Service Act* includes no provision for indexation of salaries, creating a system where individual ministries, agencies, etc. must push beyond the parameters of the Act to increase public sector pay from the 1996 levels. As a result, salary information is not transparent. It is suggested that the Ministry of Finance develop a proposal to modernise and harmonise public sector remuneration. In order to better facilitate a single public sector identity and mobility, it may be beneficial to devolve responsibility for public sector remuneration to heads of administrative agencies (*e.g.*, ministries/agencies/inspectorates, etc.) rather than ministers. This would mean that heads of ministries and agencies would be responsible for negotiating and setting pay rates within their own organisations. However, before devolving responsibility, it is advised that a salary classification system first be agreed and rolled out across the public administration so as to increase the transparency of salaries based on job descriptions, and also to simplify salary calculations.

Building a common agenda

Building a common agenda involves helping governments anticipate and flexibly respond to an increasingly complex policy environment. It enables them to make decisions which are in the public interest and which maximise the efficient and effective use of resources. A multitude of strategic plans means that many strategic perspectives currently do not fit into the whole-of-government vision and are simply left out of resource allocation decision making. While the government can and should continue to prioritise, it also needs to improve its ability to synthesise and respond to multiple perspectives and information sources. This requires an ability to understand and balance government values, society preferences, current and future costs and benefits, and expert knowledge and analysis. It also requires using this understanding coherently for objective setting, decision making, planning, and prioritisation of public resources. This will require:

- enhancing cross-sectoral strategic planning;
- modernising the performance and budget systems; and
- establishing frameworks for effective decision making.

Enhancing cross-sectoral strategic planning

Developing a longer-term whole-of-government strategic agenda will help to provide Estonia with renewed direction

In a small state such as Estonia, building a common agenda helps to provide direction for focusing limited resources. This requires inter-related long- and short-term planning, based on a whole-of-government vision, understanding and knowledge. Estonia is aware of the need for strategic vision. It has three key horizontal strategic documents in place – Sustainable Estonia 21 (2005-30), Strategy for Competitiveness (2009-11) to be replaced by the Estonia 2020 strategy, and the National Security Strategy (revised in 2010). While a step in the right direction, these strategies do not provide a common societal agenda for the country that includes consultation with all political parties, the public administration, citizens, business and civil society for achieving economic, environmental and social outcomes, for shaping future opportunities for competitiveness, and for managing risks. To ensure it has legitimacy across more than one electoral cycle, such an agenda should ultimately be discussed and agreed by the Parliament to ensure its longevity.

While it is impossible to know what one does not yet know, building foresight and capacity for responsiveness is not impossible. Building the public administration's capacity to be anticipative rather than reactive requires thinking in the long term, in addition to the short and medium terms. While it has been quipped that, in Estonia, four or five years *is* long term given Estonia's relatively recent re-independence, this will not always be the case. Building foresight skills now – not when the long term means 20 to 30 years in the Estonian context – will enable Estonia to take strategic and well-planned steps when faced with risk or other adverse situations. Foresight skills include scanning for trends, identifying patterns, and interpreting information from diverse sources. Such capacity resides in part within government, but is enriched and expanded when government taps into a variety of perspectives and takes a multi-disciplinary, multi-stakeholder approach.

Strategic planning requires co-ordination, collaboration and prioritisation

Until 2008, there were over 200 policy strategies in operation in Estonia's state administration. This indicates a gap in the effectiveness of its co-ordination mechanisms and priority-setting mechanisms. For a small country, this large volume of policy strategies was unmanageable, and blurred strategic vision, coherence and prioritisation. In 2005, a strategic planning regulation was introduced in a bid to streamline and reduce the number of strategic plans. This regulation has helped simplify strategic planning in the public administration, yet there are still approximately 100 strategies in operation. While there has also been some effort to group strategies, it remains unclear how they link with each other and with the three "guiding strategies" (Sustainable Estonia 21 Strategy, Strategy for Competitiveness, and National Security Strategy). Hence, there may be missing links between the plans and the budget process; between ministries for policy co-ordination; between ministries and their agencies in implementation; and between the central and local authorities.

While the strategic planning regulation provides guidelines for the development of strategic plans, operationally the hierarchy and prioritisation of plans is unclear. The tendency has been for ministries and government bodies to develop many plans, because having a plan approved by Government was perceived to be helpful during budget negotiations. However, this seems to be the extent of their value, as only approximately one-third of plans are said to be actually used and monitored. In addition, strategic plans

often grow apart quite quickly over time and are not updated or actively used as management tools – in this case, strategic plans tend to be static rather than dynamic. Currently it appears that only the Ministry of Finance and the Government Office participate in the planning process for sectoral strategies.

While in theory all strategic plans have been agreed at the political level, these plans are not linked to an overall prioritisation system. The Ministry of Finance has undertaken preparatory analytical work to combine and rank priorities in existing strategic plans as a first step towards streamlining strategic plans and better integrating strategic and budgetary planning. This process is being handled as a technical one, however, rather than as an active process of political decision making and trade-offs. A technical process is insufficient to develop a hierarchy of needs. Political involvement in the development process is needed, however, to ensure that the resulting hierarchy of objectives has political ownership and buy-in. Rather than being managed by the administration, prioritisation for competing goals between ministries should be undertaken and agreed upon by politicians. For this to occur, however, there needs to be a political-level process in place.

Many strategic plans will end in or around 2013, which provides the opportunity for further streamlining, prioritisation and integration of any new plans. Rather than expending efforts to prioritise existing plans, it may be more useful to take this opportunity to develop new plans within a hierarchical framework. This would enable a fresh start.

Modernising the performance and budget system

Linkages between strategy and budget could be further strengthened by implementing performance budgeting

Linkages between strategic and budget frameworks help to provide governments with a clearer picture of where public finances are being spent, to allocate resources to policy priorities, and to make it easier to track spending against the achievement of policy outcomes. In recent years, Estonia has taken steps to increase linkages between strategic and budget frameworks. The implementation of strategic planning as part of the 2003 revision of the *State Budget Act* resulted in the adoption of an annual State Budget Strategy (on a four-year rolling basis). As part of the development of the annual State Budget Strategy, ministries submit an Organisational Development Plan with an attached financial plan to the Ministry of Finance. These Organisational Development Plans are linked to Sectoral Development Plans. Introducing the State Budget Strategy and linking it to ministry Organisational Development Plans has made some progress in strengthening the connection between government strategy and financing. However, links between sectoral medium- and long-term plans are weak, and the use of Organisational Development Plans may also result in reinforcing sector silos. In addition, if sectoral strategies are not operational, they tend to have little impact in adjusting Organisational Development Plans. In this case, further work should be done to increase linkages between strategic and budget frameworks. Organisational Development Plans also need to link to sectoral strategies.

More closely linking strategic and budget frameworks in Estonia will create both the mechanism and pressure to prioritise government objectives and use of resources. Developing a hierarchy of strategic plans is a good first step towards achieving better prioritisation of the government's resources. However, in order for prioritisation to be effective, the government needs information regarding the effectiveness and efficiency of its programmes in achieving state objectives. Lingering impacts of the global financial and

economic crisis, and demands by citizens, are placing increasing pressure on the government to show that it is providing value for money in the use of public finances. Estonia could benefit from implementing a performance budgeting system as a means of using performance information to help improve expenditure control, as well as public sector efficiency and performance. This is a medium- to long-term process that will not result in immediately exploitable results. The implementation of performance budgeting, however, does begin to work immediately on slowly changing the culture of the public administration by forcing conversations on priorities (and non-priorities), indicators for success, how to achieve them, and what resources are needed. Such performance dialogue – between the Centre of Government and ministries, between ministries and agencies, and between state and sub-national government – ultimately helps to build the common agenda needed to work as a single government.

Performance information in the budget process can be used to gain insight into how different programmes contribute to the achievement of the executive's policies and priorities. Depending on the type of performance information captured, it can also help to explain why some programmes work better than others and whether they represent value-for-money. Used in policy and budget formulation, this information can help governments to design better programmes. In Estonia, performance budgeting is not really operational to the extent seen in other OECD countries. Performance monitoring and accountability are more informal and rely upon an expectation that outcomes will be achieved, rather than on formal performance reporting. Budgeting and decision making are based on inputs rather than outputs or performance-based criteria – there is no direct and clear link between a budgeted resource and the direct output or expected impact resulting from the expenditure. Despite increased provision of performance information in draft budgets, the Ministry of Finance has focused budgetary negotiations on the cost of budgetary inputs sought rather than on the most effective use of public finances. In addition, in the absence of a clearly designated costing methodology, ministries and agencies employ various costing methods, making it difficult to estimate the resources required to achieve set objectives.

The Ministry of Finance is aware of the benefits of performance budgeting and has been undertaking preparatory work towards the development of a performance management system for the State administration. The proposal, which has yet to be agreed upon by government, proposes implementing a series of changes as a means to increase the efficient and effective use of public finances.

In addition, the Ministry of Finance is considering a programme budgeting system, where the planned costs, revenue, investments and financing transactions in the Government Strategy and annual state budget would be presented on a programme basis. The budget would contain information on outcomes for each organisation, and these objectives (which which would not generally change from year to year) would stem from the long-term strategic plans provided. In addition, programme budgets would be drafted based on actual costs related to the achievement of the programme objectives, thus differentiating between direct and indirect programme costs. This would include development of a standard costing methodology for use in drafting budgets to enable more accurate calculation of the cost of programmes. The State Budget would be drafted based on programme budgets, to be submitted by ministries.

It should be noted that the implementation of performance budgeting will not in itself mean that performance information will be used in budget decisions. For that to

happen, performance information must be integrated into the budget process. However, doing so is not just a technical problem left to "experts". It will require a fundamental change in how the public sector is managed – necessitating significant changes to areas from operational management to personnel assessment to strategic planning to budgeting. It also requires a cultural change, whereby performance information becomes valued as essential to good management.

Efforts to introduce performance budgeting at the state level would build on international good practice and would be consistent with similar efforts in other OECD countries. Embedding performance budgeting in culture and decision making, however, takes time in all countries. Estonia would need to be realistic regarding implementation timeframes and take a "learning by doing" approach in rolling-out such reforms across government. Estonia should consider the type of implementation strategy it would utilise to implement performance budgeting (see Table 1.1), paying close attention to timing of the roll-out; training of staff and politicians (government and the Parliament); and communications.

Table 1.1. **Performance Budgeting: Summary of country implementation strategies**

	Strategies		Coverage		Timescale	
	Top-down	Bottom-up	Comprehensive	Partial	Big bang	Incremental
Australia		X	X			X
Canada	X		X			X
Denmark		X		X		X
Korea	X			X	X	
Netherlands	X		X		X	
Sweden		X		X		X
United Kingdom	X		X			X
United States	X		X			X

Source: OECD (2007), *Performance Budgeting in OECD Countries*, OECD, Paris.

In light of the particular challenges in rolling-out performance budgeting systems to date, Estonia may wish to consider the following path:

- **Strategy:** Top-down, reflecting the leadership role of the Ministry of Finance in this area and the need to develop a consistent understanding and approach across government.
- **Coverage:** Partial, in the short-term, in order to provide a proof of concept through the use of pilots, but with the understanding that the system will have comprehensive coverage in the longer term as it is extended to the rest of the public administration. Critical to this two-step approach is an explicit evaluation component to be able to refine the approach and to learn from initial experiences.
- **Timescale:** Incremental, given the need to develop competencies and experience in implementing the system. Implementation in waves could include sharing staff from successful projects to help lead and train staff in ministries just starting to launch their performance budgeting systems.

In preparing to implement performance budgeting, Estonia would need to be mindful of the need to align and integrate operational and HR management practices to the performance budgeting system. It would require linkages to the implementation of an individual staff performance management framework to ensure the accountability of

performance outcomes. Estonia would also need to increase capacity in all areas related to preparation and use of performance information and its application in the budget process. This includes financial management staff in ministries, the budget area within the Ministry of Finance, senior management in ministries, and ministers and the Parliament. This would be critical to gaining cultural change and to successfully implementing and embedding the reform.

In addition, the implementation of performance budgeting would also need political buy-in and support to ensure that: *a)* the system can be implemented; and *b)* information collected through performance budgeting is actually used in an appropriate manner. Thus, the Ministry of Finance should look to develop a clearly articulated business case describing the need for reform, the benefit of the reform, the expected deliverables and timeframes for implementation, and the cost of implementation. It should also detail the expectations of various actors in the public administration and government, and provide a detailed transition strategy. The Ministry of Finance may also look to countries with fully operational performance budgeting frameworks that are integrated into decision-making processes to learn from their experiences of implementing and operating a performance budgeting system, these include: Australia, Canada, Denmark, Sweden, and the United Kingdom.

Enhancing financial reporting to better track government revenue and expenditure

Government accounting systems are used to track revenue, commitments, payments, arrears, liabilities and assets. The accounting base may be cash, accrual, or some combination of the two. While Estonia operates a full accrual accounting system, the state administration struggles to utilise all of the management information collected and to incorporate it in decision making at the political and administrative levels. In small states, it is critical to be able to track and monitor resource use to inform decision making. To begin addressing this problem, the Government has approved the implementation of the Shared Support Services project. This will centralise all financial bookkeeping and accounting systems across the State administration in order to standardise the collection and reporting of financial information. The aim is to make this information available in a central repository so that it can be more conveniently used in government decision making.

In addition to centralised financial reporting, the Ministry of Finance has been considering an ambitious plan to implement a full accrual budgeting system to operate in parallel with its accrual accounting system. The Government has yet to agree to the implementation of accrual budgeting, but the Ministry of Finance is running pilot projects in collaboration with several ministries and plans to run an accrual budget alongside the cash budget in 2011. The implementation of an accrual budgeting system is a complex choice for any government. Officials have expressed the hope that a requirement to produce accrual budgets will lead to better understanding and use of accrual accounting information already in place. While accrual budgets have a number of benefits, their implementation does not guarantee better reporting information, especially if the underlying skills gap is not addressed. Only four OECD countries (Australia, New Zealand, Switzerland and the United Kingdom) run both full accrual accounting and full accrual budgeting systems. In light of this, any decision to implement a full accrual budgeting system in Estonia should not be taken lightly and should assess implementation and ongoing operational costs against expected outcomes.

One of the stated reasons for establishing an accrual budgeting system in Estonia is to oblige staff to make better use of the accrual accounting information already available. For

the moment, such data is under-utilised, and most staff lack a full understanding of how it could be used. While moving to an accrual budgeting system does require an understanding of accrual principles, absent explicit efforts to develop these competencies, the move to accrual budgeting could be counter-productive. Any decision should also consider options for further enhancements to the current cash-based system in order to make better use of existing accrual accounting data for reporting and monitoring. If Estonia is committed to introducing accrual budgeting, then it should consider a phased implementation over the longer term and/or implementation of a combination of cash and accrual systems such as those operating in Canada, Denmark, Finland, Iceland, Italy, and the United States. However, given the size of the Estonian public administration and public budget, the implementation of an accrual budgeting system should not be a top reform priority.

Capacity to prioritise and re-allocate financial resources can help to increase efficient and effective outcomes

In the face of the global financial and economic crisis, Estonia curbed its growing spending budget (as opposed to offsets budget). Programme/policy reviews are an excellent tool to help governments identify under-performing spending areas in order to free up resources for re-allocation to priority areas. This could help release pressure on social spending which is straining existing resources. Developing a culture of regular reviews not only increases the flexibility of financial resources to target areas of need, but also instils a performance mindset. The use of management and reporting information along with performance reviews helps governments re-prioritise and re-allocate financial resources.

In Estonia, re-prioritisation and re-allocation of the annual state budget occurs in two ways: through supplementary budgets, and through budget amendments. However, with the exception of activities during the recent global financial and economic crisis, budget re-prioritisation and re-allocation has not been a common feature in the Estonian budget context. Due to a strong period of growth and budget surpluses, ministries were accustomed to using supplementary budgets to increase programme spending. Thus, while mechanisms are available for re-prioritisation and re-allocation of the budget at the macro-budgetary level, they were not tested on a large scale until the onset of the global financial and economic crisis.

Unless it is part of a supplementary budget process or budget amendment as approved by the Parliament, there is little room to re-prioritise and re-allocate budget allocations. Budget flexibility will become more important in the post-global financial and economic crisis environment of reduced spending, as attempts are made to re-balance the budget into a surplus. In addition, without regular budget reviews it will become increasingly difficult to re-prioritise programmes and services and to re-allocate funding during periods of business-as-usual (*i.e.,* a non-crisis environment). While Estonia does have annual reviews, they are very technical and come too late in the budgetary process to be useful in budget decision making. These reviews tend to be seen more as a book-keeping issue than being used to prioritise budget resources. Annual programme reports are also currently prepared for the Cabinet, but again, these are also not linked to decision-making processes. Estonia should look to adapt its current review mechanisms to incorporate programme performance information and to integrate these into budget decision-making processes.

Establishing frameworks for effective decision making

An evidence-based decision-making culture can help to achieve government objectives

While evidence-based decision making exists in the Estonian public administration, it remains under-developed and under-utilised.[6] Public sector decision makers in most areas tend not to use available data to drive their policy decisions. As a small state with limited resources, Estonia must make the most of the resources it has and ensure that their use will provide the most efficient and effective return. Evidence-based decision making is a key tool through which governments and public administrations can examine and measure the likely benefits, costs and effects of their decisions. It is an extremely beneficial exercise for governments. Estonia has some way to go in order to develop and implement a fully integrated evidence-based decision-making framework.

Currently, there is no framework in place to support an evidence-based decision-making culture within the public administration and government. There are only limited and relatively general formal obligations for ministries to explain or justify why a regulation is being enacted. Bills do not include robust impact assessments. Environmental and finance laws are currently the only policy areas that use impact assessment, and these focus only on certain areas (for example, social impacts are not assessed). While there is support in some ministries to undertake impact assessment, it is generally not supported at the political level; some leaders believe that doing so will reduce the government's ability to undertake *ad hoc* work. At this stage, there is no clear proposal for the implementation of Regulatory Impact Assessment (RIA) as part of governmental decision-making processes. Estonia should therefore look to develop and systematically implement a framework for RIA in the public administration. Estonia could look to the success the United Kingdom has had in strengthening the use of *ex ante* impact assessment in its public administration through efforts to appropriately allocate responsibilities, such as ministerial accountability, use of economists to support the monetisation of costs and benefits, and defining areas responsible for actually undertaking impact assessments.

Evidence-based decision making depends on appropriate evidence bases from which to draw information. Ideally, this should include information coming from five areas: political; research and technical; professional and practical; citizen; and the public administration. In this way, decision makers can obtain a breadth of knowledge to appropriately and adequately inform decision making. Estonia has bodies which provide information that can be used as part of decision making, including the Estonian Institute of Economic Research, universities, and Praxis. However, at the moment there is an over reliance on research and analysis from only a few evidence bases for decision making.

Citizen engagement (including civil society organisations, businesses, and non-government organisations) is an effective means by which governments can gain support and buy-in for their decisions, actual or planned. Citizens can also provide innovative ideas for solving policy problems or delivering services. Estonia has experienced a dramatic increase in living standards over recent years. Effective citizen consultation is critical to gaining society's agreement as to how Estonia's growing wealth should be used *(e.g.,* reducing taxes, increasing social transfers, improving services). While the public administration already undertakes a number of citizen participation activities, the vast majority of consultation occurs in the final stages of policy development, after a bill has already been drafted. Thus, consultation occurs too late in the policy development and implementation process to effectively influence decision making. To be effective,

consultation should begin at the concept stage. However, this requires a civil society that has the capacity and capability to engage with government and the public administration in a productive manner, which is currently lacking in Estonia. Estonia should look to fully integrate citizen engagement practices as part of an RIA framework.

Analytical decision making requires both capacity and capability

There is limited analytical capacity within the Estonian public administration to support key decision making. This has been observed at the whole-of-administration level, within sub-organisations, at the managerial and leadership level, and at the individual level. Analytical skills capability includes the ability to identify, define and solve problems, and to make decisions based on a wide variety of information. This involves applying logical and strategic thinking to research and gathering information from diverse sources; identifying and scrutinising the information through analysis; designing and testing innovative solutions; and using this information to develop action plans.

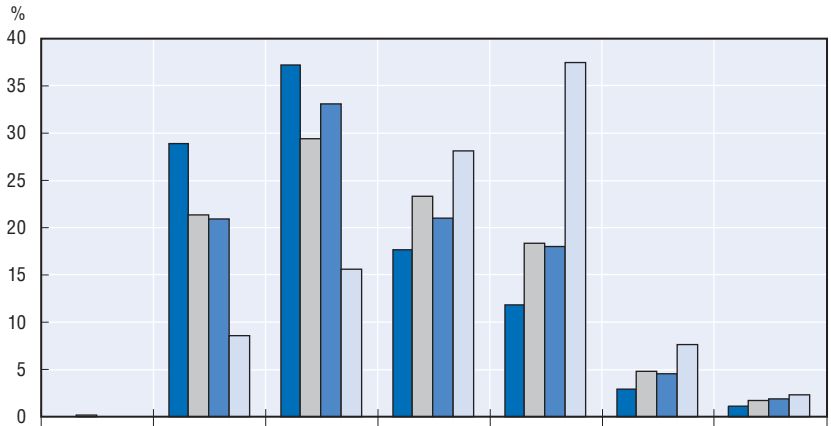
In Estonia, there is a general lack of both capacity and capability to use many sources of information and to synthesise the information into an analytical position. This is particularly evident in the area of citizen engagement, where it has been stated that the public administration and government find it difficult to deal with "multiple voices" and to take the information received and analyse it to develop solutions that will benefit the majority. This lack of capacity and capability may be a result of multifunctionalism, a key characteristic of small states; or of prioritisation in which consultation is considered a secondary activity rather than a crucial step in assuring regulatory quality and stakeholder buy-in. Due to limited resources, public administration staff are often required to be operational across multiple policy areas, which can limit the depth of knowledge in any one area. This can impact officials' ability to prepare analysis in a form and fashion necessary to fully inform government decision making.

Analytical capacity is particularly important for ministry staff that are responsible for developing policies and legislation, and preparing briefings that contribute to political decision making. Yet analytical quality varies by ministry, and limited analytical capacity may be due to a lack of operational experience among public sector staff. This can be evidenced by human resources (HR) statistics. Ministries have the largest number of officials with higher education qualifications (83.4%); the youngest staff (66.4% aged 21-40 years; see Figure 1.9); and the shortest length of service (61% with length of service of 10 years or less).

In addition, there is high staff turnover in ministries (where 20.4% of officials left in 2009); staff work on a project basis, resulting in a severe lack of institutional memory. This can be linked to an absence of continuity of knowledge due to staff departures and an under-developed habit of documenting work. One consequence of low institutional memory is difficulty for the public administration to provide sound analytical advice. A lack of mobility also impacts the public administration's ability to flexibly respond to the needs of the government. The silo-ed nature of sectoral ministries and low mobility lead to limited ability to quickly assemble a team of experienced policy analysts with appropriate skills to work on emerging, complex policy issues that are horizontal (cross-sectoral) in nature.

To counteract this, ministries have developed policy analysis units. However, due to a lack of time and human resources, the central ministries are operating on a skeleton staff and thus analytical capacity still suffers. An absence of middle management results in less vetting of the quality of work that is produced. This is a problem, particularly when the public administration has a strong reputation for relying on theoretical and international best

Figure 1.9. **Distribution of state officials by age, 2009**



	< 21	21-30	31-40	41-50	51-60	61-65	> 65
Ministries	0.0%	29.0%	37.4%	17.7%	11.9%	2.9%	1.0%
Subordinate agencies of ministries	0.2%	21.4%	29.5%	23.4%	18.4%	4.8%	1.7%
Constitutional institutions and their agencies	0.0%	21.0%	33.2%	21.1%	18.1%	4.6%	1.9%
County governments	0.0%	8.6%	15.7%	28.2%	37.6%	7.7%	2.3%

Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

practice for policy development. Poor analytical skills and operational experience risks policy development without sufficient linkages to the Estonian context. This "off the shelf" policy development reduces the effective achievement of policy outcomes and often results in the implementation of policies that require re-working at a later date, increasing expenditure.

In order to increase the capacity for analytical ability, Estonia should look at recruitment practices in its public sector organisations to ensure that selection criteria are weighted towards a demonstrated experience in strategic thinking, research and gathering information, problem solving, developing innovative solutions, etc. In addition, training and development opportunities should be provided to existing staff to increase the capacity of current employees.

Efficiencies can be gained by formalising decision-making guidelines

Efficiencies can be gained by streamlining the policy decision-making process. Valuable resources within the public administration are wasted through re-work due to an absence of formal rules on decision-making processes relating to the development of policies and legislation. Estonia does not have a formalised Cabinet handbook or internal government Cabinet guide to assist ministers and public officials in the preparation of matters to be dealt with at government meetings. As such, the public administration spends considerable time and resources developing policy and draft bills without the express authority of the Cabinet to do so.

Currently, when the public administration wishes to develop policy or legislation, individual ministries create concept notes which are given to the relevant minister for approval. At this stage, the concept is usually not agreed upon by the wider Cabinet. Ministries then prepare a full draft bill. While there are formal rules for the policy process, ministers are not required to seek approval from the Cabinet before developing concepts or legislation. Thus, much work is being undertaken by the public administration without a mandate from government to do so.

The first time Cabinet ministers are involved in the process is when the full draft policy or bill is brought forward to the Cabinet. While concept papers are used, full drafts of policies or legislation are often developed and provided to the Cabinet before it sees the concept or proposal. More often than not, the bill is in no condition to be agreed upon by the full Cabinet and is sent back to the public administration for amendments. This leads to re-work and points to the need for the public administration to improve its analysis and development of business cases. It also highlights a potential lack of trust between the political level and public administration.

As the lead time in developing a bill is lengthy, in many cases the public administration has already started to put structures in place to support the work being developed in a draft bill, even before it is agreed upon by the Cabinet and Parliament. This leads to a lot of stopping and starting, as there is no clear strategic agreement on the business case for reform. This waste of time and resources could be avoided if ministers and the public administration sought approval from the Cabinet on a concept paper before drafting a full bill. It is suggested that Estonia look to implement a formal Cabinet Handbook, similar to those used in Australia, Ireland and the United Kingdom.

Delivering public services effectively

Citizens and businesses expect public services that are adapted to their needs and which are seamless, as if provided by a single government. Effective service delivery therefore requires a whole-of-government approach that involves both central and sub-national government actors, as well as external stakeholders (*e.g.*, national and municipal associations, civil society, the private sector, and citizens). In a small country, delivering services in a joined-up way across levels of government should be easier than in larger countries with more governmental layers. However, several challenges inhibit Estonia's ability to achieve a single-government approach to public service delivery. These relate to national and sub-national administrative structures, relationships between levels of government, and broader issues of territorial management. The result is fragmentation in central service delivery (*e.g.*, in e-government services), and difficulty in effectively and efficiently delivering public services of equal quality across the territory.

Developing a coherent approach to public service delivery

The capacity of the public administration as a whole to realise its policy objectives is currently undermined by insufficient linkages between the ministries as policy-making authorities, and the sub-national bodies that have implementation responsibility for many of these policies.

The disconnect between policy objectives and service delivery can be reduced, in part, by removing barriers for different parts of the public administration to work together. Fragmentation of standards and approaches – and the lack of basic templates for common processes, decision making, and co-operation agreements – all contribute to these barriers, as do sector and level-of-government differences in training and working methods. A stronger, more coherent enabling environment is needed to provide a common platform for collaboration across state and sub-national government and among municipalities. This requires a strong and consistent approach to administrative development, for example addressing common quality standards and measurement methodologies, service level agreements, ICT services, and training needs.

Currently, each sector ministry is responsible for its own administrative development; the vertical and silo-ed institutional structure reinforces fragmentation in administrative development, as well as in central and sub-national service delivery. There are some central co-ordination responsibilities at the state level, notably for the Ministries of Finance (administrative development), Justice (regulatory management), and Economy and Communication (ICT infrastructure), and for the Ministry of Interior/Regional and Local Affairs at the sub-national level. However, differing approaches among these core ministries and, in some cases, a lack of a clear mandate, weakens their capacity to develop service delivery tools for the rest of the public administration. To overcome this, greater clarity in responsibilities, expectations and accountability for all levels of government is important. Finland has addressed this issue by consolidating responsibility for administrative development, including municipal management, in the Ministry of Finance.

Given weak co-ordination mechanisms in the Estonian public administration, the current structure does not provide optimal results, evidenced for example by policy and service-structure incoherence at the sub-national level, and the slowness with which common tools and platforms are being developed. Improved co-ordination allows targeting of scarce resources, reduces redundancy, and enables the sharing of the cost of developing administration tools. Estonia could reinforce its enabling environment for improved service delivery by further consolidating administrative services responsibilities or by requiring the participating bodies to develop a common plan based on optimising public value by creating common tools and standards, for example, building on what has been accomplished in the area of data-sharing.

Effective public service delivery by all levels of government

Public services are delivered by all levels of government, either directly or indirectly, and are a key area of concern for governments and citizens alike. Increasingly, the role for governments is shifting from one of direct service provision to one of service facilitation as the number of actors providing public services, especially at the local level, is growing. Citizens, however, rarely distinguish between who or which level of government is providing the services – they are more concerned with service access and quality.

In Estonia, sub-national authorities are under the jurisdiction of the Ministry of Interior/Regional and Local Affairs, while sector policy guidance and regulation depend on the competent sector ministry. This can lead to policy-, oversight-, and information-gaps between the central and local levels. These gaps can be exacerbated depending on the source of funding for services. For example, in the area of social care for the elderly, the Ministry of Social Affairs has policy competency, but services are primarily funded by municipalities. As a result, the Ministry is hesitant to establish service standards in this area, and the County-level authorities only inspect social care facilities in cases of complaint. In the end, no public body has complete responsibility for ensuring that the elderly have access to and receive quality social care. Improved alignment of all of the relevant actors affecting a policy area would help to clarify regulations and identify cross-sector interactions *(e.g.,* between health and social services), in order to focus central and sub-national actors on agreed-upon policy objectives, thereby clarifying their own responsibilities. This was seen in Finland with the ALKU regional reform, which addressed both co-ordination and streamlining in central/sub-national relations. Although it is important to identify the responsibilities of each party in a policy initiative and individual

actors (*e.g.,* line ministries, counties, local authorities) must remain responsible for their inputs, there should be shared responsibility for the outputs and outcomes.

In general, successful public service delivery is thought of in terms of effectiveness, encompassing efficiency, equality of provision, access, and quality. It has been recognised, however, that public service performance cannot be evaluated only in terms of the efficient and effective use of resources, but also must consider the capacity of public services to generate public value for key stakeholders (*i.e.,* citizens, businesses, clients, public sector employers and employees, and society as a whole). Thus, in order to improve service delivery, it may be more appropriate to place greater weight on citizen satisfaction with the mix of services, and then consider other elements of effectiveness (including efficiency). This would go hand-in-hand with current innovative models of service delivery, such as co-production, which focus on the role of service users in designing, delivering and evaluating public services.

Improving central government service efficiency through shared services and consolidation

Like all countries, Estonia is looking for innovative ways to reduce central government administrative costs at the sub-national level, while also improving performance. It is approaching this in the "back office", as well as through a more publicly visible experiment. A county government Shared Support Services project initiated by the Ministry of Interior/ Regional and Local Affairs has consolidated the accounting and personnel functions ("back office") of all counties into a central location outside of Tallinn. This has reduced administrative staff and costs at the county budget level.

At the "front-office" level, and thus more visible to citizens, is the "State House" project. Conceived in Lääne County; it is an experiment undertaken by Lääne County, the Ministry of Interior/Regional and Local Affairs, and the Ministry of Finance in a move to improve the accessibility of State-level services, rationalise the use of State real estate at the county level, and be more citizen-focused in service provision. The project creates the possibility of merging all local State representation (*e.g.,* ministry, agency, foundation, etc.) into one physical working environment, including the harmonisation of IT systems and public service practices. This is a good example of a cross-sectoral, vertical initiative to improve the co-ordination, function and provision of central government services at the sub-national level. It is an initiative that could be considered for implementation in other counties.

The "State House" concept may also provide a model for future integration of county functions into fewer administrative areas. This may also be a way to introduce coherence and manage the scattered and *ad hoc* fashion in which ministries and their agencies have established their sub-national entities across the territory. This action by the ministries, while potentially logical for their own activities, makes co-ordination difficult and service provision potentially confusing for citizens. Improving service standardisation and back-office functions, and then grouping the State's sub-national activities into fewer centres across the country (either under one roof or housed in proximity) could bring coherence to the system.

Serving citizens through e-government and e-services

E-Government and its associated services are critical tools for using resources to achieve better service delivery outcomes for citizens and businesses. Administrative and infrastructure capacity is critical to creating a strategically agile public administration. At the same time, capacity (in terms of accessibility and levels of use) by targeted users is also essential; otherwise, even the most innovative developments risk low impact. E-Government can help to

maximise the use of limited human and financial resources by supporting the development of innovative capacity, and improving flexibility and responsiveness of the public sector. However, it requires an overall vision to stimulate actors to make use of the ICT tools available to them and to collaborate with one another for efficient and effective service delivery.

Experience from OECD countries indicates that a well-developed enabling environment *(e.g.,* legislative, budgetary, infrastructure frameworks) is a crucial prerequisite for the implementation of e-government. Estonia has a well-established state infrastructure, including systems and components to support e-government development, similar to those in the most advanced OECD countries, *e.g.* Finland, Norway. This infrastructure – which includes a secure data transport backbone X-road, different hardware and software components like the state portal, a public key infrastructure (PKI) and governmental databases and information systems – provides the basis for enhanced connectivity across the government.

The high quality of e-government infrastructure, however, is not reflected in a similar high quality across online public services, whose development falls under the responsibility of each sector ministry and local municipality. Such an approach impacts the public administration's overall capacity to develop effective and efficient e-government services at all levels of government. There are examples of good practice, or "stars" in Estonia, such as e-taxes and e-voting. But there are also many areas that lag behind.

The inconsistency in service delivery quality and results appears to be due to insufficient co-operation across the Estonian public sector (*i.e.,* State ministries, and sub-national authorities) for the development of e-government services. While Estonia has excellent IT infrastructure, this needs to be more strongly linked with an overall approach and responsibility for service delivery which puts the citizen at the centre in order to promote horizontal and vertical co-operation for e-government services. Therefore, implementing a whole-of-government approach will contribute to overcoming the current problems in designing and developing high-quality e-government services in the public administration.

Increasing co-ordination within and across levels of government, or assigning the responsibility for the administrative development of e-government services under the same organisation holding a mandate for other areas of the public administration, could help address the inconsistencies in e-government services supply associated with sectoral-led development, and not generally evident when evaluating aggregate indicators. Increased co-ordination may be achieved through a number of different arrangements. OECD countries' experiences show that approaches to e-government co-ordination vary greatly, reflecting the political and administrative tradition. Some countries have created strong national chief information officer positions or CIOs councils (*e.g.* Austria, Australia, the United Kingdom, the United States) while others have relied on the establishment of co-ordination bodies gathering all main stakeholders (*e.g.* Denmark, Switzerland, Mexico).

Increased e-government co-ordination is particularly needed at the sub-national level through the development of common solutions or frameworks (*e.g.* basic security infrastructure, connectivity systems, and interoperability frameworks) which, in Estonia, have not been developed adequately to support more integrated service delivery between the central and local levels of government and across local municipalities. Overall, ministries and local authorities need to learn how to develop a "business case" for developing and providing services collaboratively, which would help them to meet the

pressures of fiscal consolidation, while increasing synergies among services offered and fostering a stronger user focus.

Improving the offering, quality and user-focus of e-government services requires not only a driver to push information and experience sharing, to create frameworks and incentives for collaboration, and to set whole-of-government strategic directions for the development of e-government; it also implies higher harmonisation of IT systems, and building central, as well as sub-national, capacity. The latter could take the form of identifying and sharing good practices already integrated into the activities of other ministries; working more closely with the private sector to identify needs and build systems to meet them; continuing to improve and facilitate access to necessary technology (such as e-ID card readers). Initiatives in this area, together with more efforts targeted at increasing public awareness of available online services through marketing and advertising campaigns, can help Estonia boost user take-up, and continue building on the significant progress it made in this domain between 2007 and 2009.

The key is to understand that e-government services need to be viewed as part of a multi-channel service delivery strategy, and as a strategic driver for improved and joined-up services organised around citizen needs.

Tailoring service delivery requirements to population needs may boost effectiveness and build citizen satisfaction

Service delivery initiatives are often focused on city centres or urban areas. Yet, attention to rural service delivery and its specific challenges are important when a large part of the population lives in rural areas, as is the case in Estonia.

In many rural areas worldwide, especially the most remote, certain services are not available or are available at considerably higher cost and/or lower quality than in centre or urban locations. Although very few national governments explicitly guarantee uniform availability of public services across their territory, a growing proportion of the public perceives that spatial equality of access should be part of the statutory rights of citizens. Service delivery challenges generally specific to rural areas include: access; an ageing population; distance, critical mass and density; a decline in central government subsidies; an increasingly diverse population; less than optimum technical capacity; complex national and international supply chains; limited choice; weaker communication networks. While these may not all be applicable in the Estonian case, quite a number are.

The role of government is central, either in providing services or by influencing the service delivery decisions of private firms and the voluntary sector. Fundamentally, the question is not whether all populations receive the same service delivered in the same way, but whether the people and the firms in each place have the services that provide appropriate outcomes for their needs. This means that the ultimate test of access to services has to be framed in terms of outcomes, not outputs. Performance measurement can be of significant help here.

Given that Estonian municipalities are mandated to deliver the same set of public services regardless of size, and that many do not have the ability to fulfil their mandate, municipalities are faced with a need to make choices about the bundle of goods and services they can afford to provide. While ideally all communities should be able to provide all goods and services equally, the reality is they cannot and may not need to due to lack of

demand. Decentralisation and devolution of competences puts municipalities in the driver's seat when determining which services are needed by the community.

Decentralisation does not absolve government, neither central nor sub-national, from ensuring quality public services. Higher-quality services will result in better outcomes and more satisfied citizens. Currently, Estonia does not have well-established quality standards. In addition, municipalities are left to determine appropriate levels of quality. Local authorities, however, are concerned with providing as many of the mandated and demanded services as they possibly can. With tighter budgets not only are services cut, but service quality suffers.

Establishing that successful service delivery depends on the appropriateness of and citizen satisfaction with the mix of services provided, it then follows that both municipal typology (*i.e.,* rural, county-centre, urban) and capacity should be considered when determining which services to provide or how to provide them in a community. Tallinn, Rakvere and the island communities, for example, demonstrate variation in need and resource capacity. Thus, urban/rural policy should be matched with service delivery challenges and opportunities. Estonia's central government currently provides a full list (or bundle) of public goods and services that all municipalities must provide or provide access to for citizens, but it may need to re-evaluate how it thinks of its municipalities and the needs of citizens. For example, it may be that Tallinn and its surrounding area would be better equipped to meet service delivery challenges if it were classified as a capital or metropolitan region rather than placed in the same categorical mix as other municipalities with much smaller populations. While equity of access is important, it may be more important, as stated earlier, that the services available are of good quality and meet the needs of citizens and businesses in that area. The central government must be sufficiently flexible in supporting municipalities' ability to bundle services appropriately and to adjust the mix when required.

Ensuring municipal sustainability: A matter of scale?

As governments strive to "do more with less", many have focused on building a critical population mass as a means to achieve better public policy results. Identifying an optimal number of people per municipality for the delivery of a set of services, or the appropriate number of people to establish a service-specific catchment area, or the number of municipalities within a country that can maximise the effective delivery of local public services, remains a challenging matter. Estonia is struggling with a large number of small municipalities, the capacity of municipalities to meet their ascribed competences, and municipal fiscal sustainability.

The issue of scale has not been successfully addressed in Estonia. The current policy for voluntary mergers has weak incentive mechanisms and voluntary horizontal co-operation faces diverse obstacles, some of which are based on values and beliefs which take time to change. It is affecting the financial sustainability of municipalities and their ability to competently deliver quality public services in an effective and efficient manner. Focusing strictly on building scale as a means to address demographic, economic, social and service delivery problems at the local level may be limited in scope and alone does not provide a solution to broader territorial and regional challenges. Governments need to think through sub-national administrative reform within the wider perspective of regional development and territorial strategy objectives.

Horizontal co-operation is the primary mechanism to build scale and, thus capacity. Such co-operation can range across a spectrum of "non-integrated" or "quasi-integrated" – *i.e.*, voluntary co-operation among independent municipalities – to "integrated" – *i.e.*, mergers, both voluntary and not. Estonia has pursed both paths, seeking to induce greater co-operation among its municipalities for service delivery, as well as promoting voluntary mergers. In each instance, however, support from the central government has been weak, and incentives for the municipalities are low. Estonia's municipalities *do* co-operate, and it has been observed (as well as experienced by local officials) that municipalities that either work together or merge are in a better position than those who do not. Since the introduction of the Law on the Promotion of Voluntary Mergers in 2004, the number of municipalities has decreased by 19, from 245 to 226. Because there were no objectives set – either in terms of desired number of municipalities, or time limit, or both – it is hard to determine a level of success. However, unless objectives are clearly established and incentive mechanisms are built into the system, along with associated guidelines and legal requirements, non-integrated co-operation may not evolve much further, and voluntary mergers may remain few and far between.

Sub-national finance

Figures 1.10 and 1.11 put elements of Estonia's sub-national finance in perspective *vis-à-vis* OECD countries. Both in terms of municipal revenue as a percentage of general government revenue and expenditure as a percentage of general government expenditure, Estonia is below the OECD average. This reflects limited fiscal decentralisation, which in a small country is not unusual.

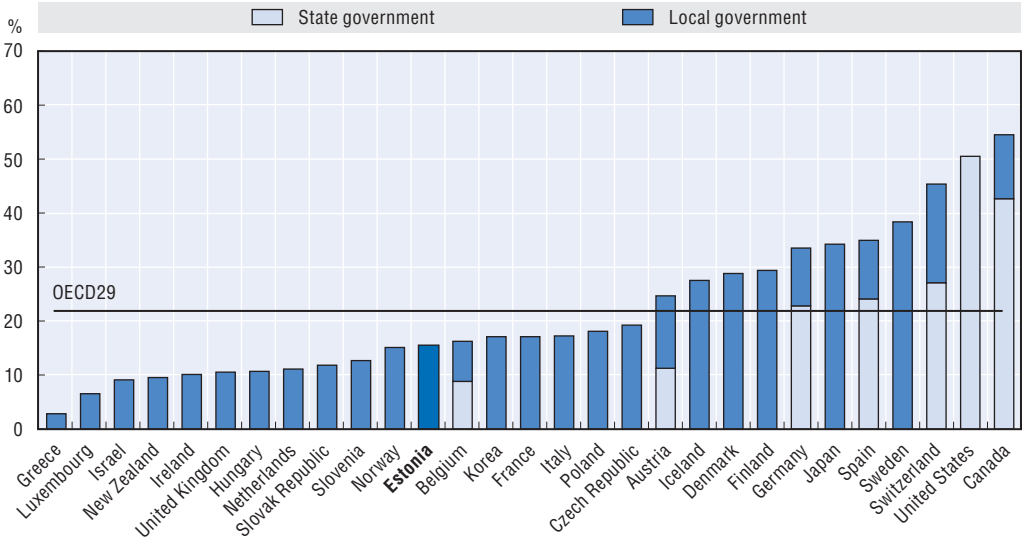
Municipal finances are quite centralised in Estonia, with approximately 80% of municipal revenues centrally regulated *(e.g.*, personal income tax, grants, and an adjustable land tax) (see Table 1.2). Estonia has decentralised spending decisions – municipalities can choose how they spend based on municipal and citizen needs – but not revenue choices, as evidenced by the relatively low percentage of sub-national share in general government revenues. One option is to consider a local income tax that will give voters and taxpayers more autonomy in their municipalities and enhance local democracy. It could be designed so that the tax base (including exemptions) is centrally decided, as is the case in most other countries, with tax rates left to municipal discretion. A local income tax could also give taxpayers a tool to compare their municipality to neighbouring ones, and could help improve the quality of services as well as control costs. However, such a measure should be implemented only if municipal size increases.

Some consideration should be given to improving the grant system for instance by separating cost equalisation and revenue equalisation. For example, in Finland, cost equalisation is financed in full by the central government, while municipalities fund revenue equalisation. In Sweden, the system is similar, but in the inverse: municipalities finance cost equalisation and revenue equalisation is financed primarily by the central government. The idea of municipalities participating in the costs of equalisation (either by cost or revenue equalisation) is important, as it forces them to commit to the equalisation and monitor the system's functionality.

"Non-integrated" horizontal co-operation as a means to build scale

The idea that Estonia's municipalities do not co-operate or do not co-operate enough may be misplaced. Local authorities co-operate on a wide array of activities bi-laterally,

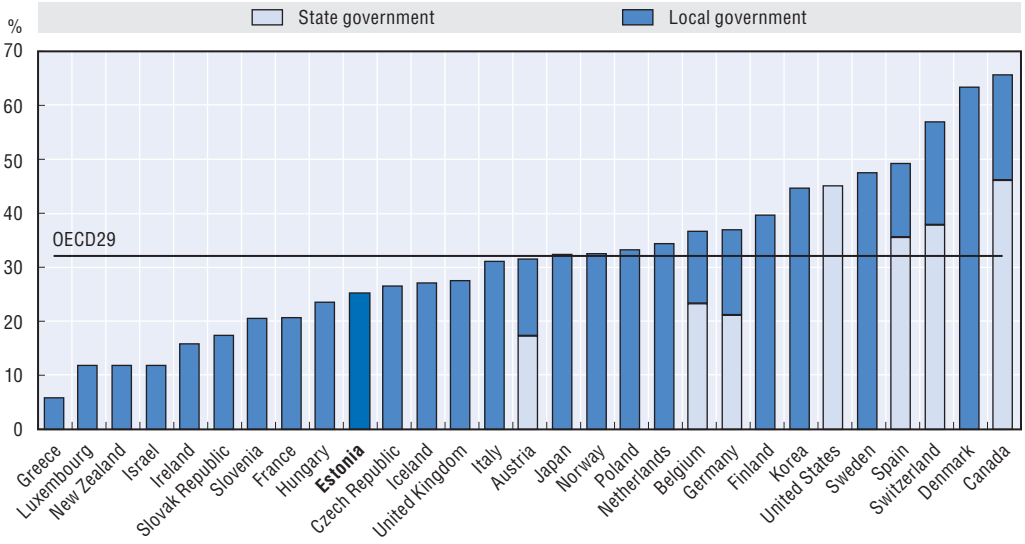
Figure 1.10. **Sub-national revenue as a percentage of general government revenue, 2009**



Notes: Data for Australia, Chile, Mexico and Portugal are missing. Transfers between levels of government are excluded. Korea, New Zealand, Switzerland, United States and Israel: 2008. Japan: 2007. Local government is included in State government for the United States. Social Security funds are included in Central government in New Zealand, Norway, the United Kingdom, and the United States.

Source: OECD (2010) *National Accounts Statistics*, OECD, Paris.

Figure 1.11. **Sub-national expenditure as a percentage of general government expenditure, 2009**



Notes: Data for Australia, Chile, Mexico, and Portugal are missing. Transfers between levels of government are excluded. Korea, New Zealand, Switzerland, United States and Israel: 2008. Japan: 2007. Local government is included in State government for the United States. Social Security funds are included in Central government in New Zealand, Norway, the United Kingdom, and the United States.

Source: OECD (2010) *National Accounts Statistics*, OECD, Paris.

through the Municipal County Unions, or even with counties and the central government. It may not be a question of co-operating sufficiently, but rather a question of co-operating effectively; co-operation levels might not be making the necessary difference in building a

Table 1.2. **Municipal revenue sources, 2003-09**

Per cent

	2003	2004	2005	2006	2007	2008	2009
Taxes	46.48	47.57	47.66	46.85	52.49	54.62	53.55
Grants	39.77	35.56	35.16	33.23	33.21	32.32	32.31
Sales of goods and services	8.39	10.94	10.43	9.03	8.87	9.66	10.77
Sales of tangible and intangible property	3.22	4.04	4.80	8.56	2.86	0.94	0.89
Revenue from property	1.44	1.53	1.23	1.65	2.03	2.02	1.98
Other income	0.71	0.37	0.71	0.68	0.54	0.44	0.50
Total	100	100	100	100	100	100	100

Municipalities have the right to regulate the rate of land tax between 0.1 to 2.5 times the taxable land price. However, land values have not been updated since 2001.
Source: Moisio (2010), *Estonian Sub-National Finance*, Unpublished working paper.

critical mass and increasing capacity. This could be due to a narrow scope of co-operation within each area. For example, there seems to be little sharing of administrative costs through joint purchasing or educational co-operation through building networks to support teacher professional development within a geographical area. It could also be due to the fact that individual municipalities remain small, so even if they do co-operate bi-laterally, tri-laterally or even wider, for specific services the mass reached may still be insufficient to realise the necessary gains.

Voluntary co-operation in Estonia, however, may not go much farther than it already has without direct guidance or financial incentives from the central government. These could be in the form of laws or legislation that require co-operation in specific instances, as implemented by the Netherlands. It could also be mandating a particular population level (a catchment area) for the provision of a specific service, as Finland does with both hospitals and vocational training. Another alternative would be to undertake a similar exercise as Luxembourg in establishing what might be a population threshold for municipalities in order to deliver a set of required basic public services. The last two alternatives require calculations for establishing population bases. Significantly, these calculations are highly country- and objective-specific.

If Estonia pursued a co-operative model that required establishing a catchment area or a population threshold, it could incorporate a democratic element by involving municipalities in the decision of how they will accomplish the mandate. Incentives should be built in, as well as sanctions for non-compliance. A trial period with clearly established timeframes and objectives should be considered to determine the success of the co-operation. If there is low co-operation, or if the expected gains *(e.g.,* citizen satisfaction, quality, efficiency and effectiveness) are not realised, it would be worthwhile to consider mergers.

"Integrated" co-operation (mergers) as a means to build scale and capacity

Countries approach mergers in various manners, ranging from voluntary to mandatory, or almost mandatory, with a specific target size, as recently seen in Denmark. Mergers face an "acceptance challenge", however, and can be a politically charged option. Despite this, mergers remain a viable mechanism with some evidence of economies of scale associated with specific services *(e.g.,* schools and hospitals) as experienced by Denmark and Finland. In the case of the latter, the PARAS reform took a combined approach to promoting horizontal co-operation among municipalities: they could merge

voluntarily, or develop joint co-operative bodies to create service areas with a centrally determined minimum number of residents in order to deliver key basic services.

Experience has shown, however, that mergers are hard to accomplish on a strictly voluntary basis. Such voluntary-based reforms take longer to process, can be very costly, and require strong guidance from the central government. Estonia's 2004 Promotion of Local Government Mergers Act has been entirely voluntary with few, and low incentive, mechanisms.[7] This could be compared to the incentive structure developed by Finland,[8] where the incentive structure for those municipalities that merged was significantly greater and more complete in its development than the system in Estonia.

If Estonia is serious about increasing municipal capacity for service delivery, it may need to consider a system of mandated "semi-voluntary" mergers, particularly as the benefits from non-integrated co-operation may be stagnant. This means that the government mandates mergers but gives municipalities the opportunity to present proposals for "merger" partners that are coherent and do not create a "Swiss cheese" effect. This is similar in concept to the Danish approach.

Another alternative is to undertake regional experiments. Experimentation in policy design and implementation can promote co-ordination and build capacity thanks to partnerships among the local areas concerned. Estonia could consider an experiment for building a co-operative area of particular scale (*i.e.,* a catchment area) for a predetermined set of services *(e.g.,* education, social services, business development, infrastructure development and maintenance) through a contractual agreement among municipalities and with a co-ordinating body *(e.g.,* the County Municipal Union). This would provide an opportunity for: *a)* municipalities to learn to work together better; *b)* actors to determine if scale in terms of population makes an impact on resource capacity and the provision of services; *c)* the government to introduce performance measurement and quality standards through the contractual arrangement, and increase the comfort level with contracts as a co-ordination mechanism. It might also offer a means to test new ways of allocating EU funds, moving away from project-based competition to programme-based co-operation.

Regardless of the horizontal co-operative approach – non-integrated, integrated or a combination – a clear policy for building scale should be established, articulated and communicated, and it should link back to territorial objectives and regional development policy.

Territorial vision and regional development

Thus far, in thinking about its service delivery challenges and requirements, Estonia has focused predominantly on questions of scale at the municipal level. However, in doing so, it appears to have under-estimated the complementary value of regional development policy and territorial vision for long-term development.

If carefully cultivated, Estonia's territorial advantages could help overcome its territorial challenges

As explored earlier, Estonia faces a series of territorial challenges: disparities in regional economic productivity and levels of employment, and an ageing population. Each of these brings a set of potential and inter-related public policy concerns: building economic competitiveness across the territory to release some productivity pressure from the Tallinn City region; meeting the social service and healthcare demands of an ageing population

while still addressing the needs of Estonia's children, particularly for families living outside Estonia's urban or county centres; ensuring fiscal capacity to fund public services despite a declining tax base; alleviating the strains of unemployment on social insurance, on labour policy, and on overall citizen well-being, economically, socially, and psychologically.

Estonia has a key territorial advantage, which should be nurtured: a relatively even distribution of its working-age population across the territory. While the numbers may be hard to maintain in the short run given the ageing population and low birth rate, Estonia could begin reinforcing territorial (*i.e.*, spatial including infrastructure, economic, labour, social, etc.) policies aimed at maintaining this distribution as much as possible, or even improving it over time with people choosing to live outside of urban centres. Otherwise, the risk is greater migration towards strong centres, particularly Tallinn, or emigration. This would result in a further reduction of municipal capacity given de-population, and increase remoteness for certain areas.

A territorial development policy that enhances the growth potential of each region requires employment and business policy initiatives to retain and enhance the current working-age population distribution and to help smooth out differences in job creation across the country. It also includes encouraging opportunities for medium- and high-value jobs and investing in the educational requirements to create such a workforce. This entails ensuring that regions and municipalities in Estonia remain attractive places to live in terms of services and employment opportunities, and that communities remain connected with each other. Both regional and local capacity for realistic planning, effective co-ordination, and appropriately tailored (and often innovative) service provision are key to these efforts.

Given Estonia's size, improving competitiveness should include unleashing the potential of the full territory. Thus, building a territorial vision that focuses on developing the country's place-based assets may be most coherent in the long run. Such an approach could emphasise various economic growth engines (*e.g.*, the service sector, industry, agriculture) and cultivate them as appropriate given unique regional endowments. This could include: building on Estonia's efforts to foster the growth of a knowledge-based economy; building the service sector, including tourism, in rural areas; encouraging the growth of SMEs outside of urban or county centres; re-evaluating Estonia's approach to industrial policy by identifying where there is value added, what can be developed further in the long-term, and how to achieve short-term gains; and promoting innovation policy for all sectors, including agriculture.

Realising a territorial vision requires attention to regional development

By helping to generate growth in regions, comprehensive regional policies are an important complement to national economic and structural policies. A nation-wide regional development policy should be the driver of an articulated territorial strategy. On the one hand, it should be Estonian in context, helping meet uniquely Estonian goals for territorial economic and social development. On the other hand, as an EU member, Estonia should continue to take EU requirements, opportunities and incentives into consideration. Regardless of how it chooses to move forward, a whole-of-government, and ideally a whole-of-society, agreement on what Estonia should look like territorially is essential to sustainably address service delivery challenges.

Arguments have been made that Estonia's county-level administration lacks the critical mass necessary to implement regional policy, and especially a place-based strategy.

This would be true of many small states, among them Denmark, Luxembourg (by far smaller), the Netherlands, and Switzerland. In any regional development approach, there are two ways to consider territorial areas and their boundaries: administrative and functional. By developing functional areas for regional planning, Estonia may be able to overcome the critical mass question.

Strengthening co-ordination mechanisms for improved territorial performance

A lack of co-ordination tools may be reducing the effectiveness of territorial development policy. In Estonia, a multitude of policies and plans across the various levels of government (state, county, and municipal) are used to manage aspects of regional development. Valid arguments have been made that Estonia lacks the institutional conditions to implement place-based regional development policies. This is particularly relevant, as such policies require effective sectoral (*i.e.,* among line ministries) and vertical co-ordination to ensure policy coherence and investment sustainability. Given the number of state and sub-national actors, as well as the large variety of plans, solid co-ordination is required to ensure that plans are coherent and that their implementation is not only successful, but that it is sustainable and able to meet broader territorial goals.

Supporting plans with budget

County development plans are not attached to State Budget lines, and the Regional Development Strategy depends a great deal on EU funding for specific projects. As expected, much of the EU-based funding goes to infrastructure *(e.g.,* schools, roads and transportation systems) on a project basis. This has been a conscious decision on Estonia's part due to a need to upgrade infrastructure. Moving forward, however, care needs to be taken to avoid "roads to nowhere". Funding allocation is a competitive process, primarily among municipalities. This can work against efforts to build local co-operation, as well as against the intention of EU funding, which is to promote co-operation and regionalisation. Thus, linking EU funding allocation to programmes associated with regional development goals, rather than individual municipal-level projects, would be a stronger and more strategic approach.

Estonia's objective should be to bring coherence into regional planning by building a single government approach with the resources necessary to realise its goals. Estonia should continue funding regional development with a combination of EU (co-financed) and central government funds. There is, however, room for greater effectiveness. It could increase the contribution of central-level funds to regional development and link these to the state budget, demonstrating support for territorial development suited to Estonia's ambitions and its context. Complementing its broader European role, re-designing how EU funds are allocated to support a larger territorial objective by taking a programme- rather than a project-based approach could improve investment outcomes, and minimise the competition between municipalities for project funds.

Enhancing central/sub-national relations for improved policy outcomes

The challenges facing the central/sub-national relationship (also referred to as multi-level governance) mirror those at the regional level: weak co-ordination and a lack of capacity to maximise co-ordination mechanisms. This relationship impacts service delivery by all levels of government, as well as local authorities and regional development.

Institutional co-ordination should be strengthened by building collaboration among sectoral ministries in central/sub-national matters

In practice, the management of central/sub-national relations is highly fragmented at the central level. The Ministry of Interior's Department for Regional and Local Affairs, headed by the Minister for Regional and Local Affairs, is the government institution responsible for leading and co-ordinating the multi-level governance relationship. It is also responsible for co-ordinating sectoral initiatives that impact the local level in order to ensure policy coherence. Yet, co-ordination capacity is low, particularly across sectors, which may be reinforced by possible internal fragmentation. The scant attention that regional development and the Regional Development Strategy receive within the government is further evidence that there is a lack of co-ordinated or collaborative input necessary to fully meet objectives. In addition, there have been delays of up to three or four years in updating the Action Plan associated with the Regional Development Strategy. While the strategy may remain valid because the issues have not changed, the way those issues can realistically be addressed may no longer be valid given the change in the economic situation.

Other OECD countries approach sub-national co-ordination in a more formally integrated fashion. From a co-ordination standpoint, in some countries territorial matters are handled by the Ministry of Interior, in others, the Ministry of Economy. The common thread, however, is that management and co-ordination is cross-sectoral, led by the relevant Ministry *(e.g.,* Sustainable Development and Infrastructure in Luxembourg, Economy and Business Affairs in Denmark) and supported by multi-disciplinary committees. Estonia may wish to consider re-evaluating how it approaches co-ordination of central/sub-national relations by increasing cross-sectoral activity at a technical level and above. This would increase buy-in, and also facilitate implementation, accountability, and performance measurement. It would also improve policy coherence among sectoral ministries and help Estonia move towards ensuring that regional and local development planning helps promote sectoral sub-national interests and also advances broader territorial aims. This would bring a "single government" approach to central/sub-national relations.

Broadening and strengthening the tools for central/sub-national co-ordination can help build capacity at all levels of government

A wide variety of tools are available to enhance the central/sub-national relationship. Many of these focus on enhancing vertical co-ordination and building capacity, especially for municipalities. Such tools range from binding to soft, and can include: legislation and laws; formal contractual arrangements; co-ordinating bodies; judicial review; informal or *ad hoc* meetings; performance measurement; and other mechanisms such as experiments or pilot programmes. OECD governments use these tools to differing degrees – legislation and laws tends to be the most popular followed by co-ordinating bodies[9] – and all use a combination of at least two of these mechanisms. In addition, many have some indicator system in place for monitoring sub-national service provision, as well as incentive structures to promote co-operation.

In Estonia, many of these tools are also used to manage the central/sub-national relationship, particularly laws and legislation. While these offer clarity, they can introduce certain rigidities in the system which can limit activity as needs evolve. This is the case with County Municipal Unions, for example, which play an increasingly important role in promoting municipal co-ordination and service delivery, locally and across counties. Thus,

while laws and legislation are popular and helpful tools, utilising more flexible means to manage central/sub-national relations may facilitate adjustments as linkages and needs evolve. Contracts between central and sub-national entities are one such tool. The Ministry of Interior/Regional and Local Affairs has developed framework contracts for central/sub-national agreements relating to ICT, and it is planning to extend these to other areas. However, the more general use of contracts or service agreements appears infrequent.

Indicator systems help promote capacity development and good management practices. In addition, they are effective tools for reinforcing accountability of stakeholders at all levels of government by improving transparency. Individual ministries in Estonia maintain various indicator systems for performance measurement. What is missing, however, is a system that can help disseminate information across levels of government, help actors identify objectives, and improve government effectiveness – be it administrative, the use of financial resources, or in service delivery. Such information can be particularly important when contracts are negotiated or co-operative partnerships are established, as performance measurement information can help each party understand the capacity level of the other, and develop an arrangement where co-ordination is optimised based on capacity in terms of resources and skill. This has been one of the benefits Norwegian municipalities see from Norway's KOSTRA system, which publishes data results electronically within a month of receipt from the municipalities.

Co-ordinating bodies are critical drivers for building capacity and sharing good practices, especially at the sub-national level. They can serve as forums for overcoming communication and dialogue challenges. In addition, co-ordinating bodies can help align interests and timing, especially with respect to implementing public policy at a horizontal level. As in many OECD countries, Estonia's two national-level municipal associations (the Association of Estonian Rural Municipalities and the Association of Estonian Cities) were established to serve as partners for both central and local authorities, negotiating matters with the central government on behalf of local members. Estonia's municipal associations face their own capacity challenge, primarily in terms of human and financial resources, which may be preventing them from serving as full and highly effective partners for their sub-national members. They have extensive and valuable knowledge and information about the functions and management of municipalities, which could be put to better use for co-ordinating the central/sub-national relationship and building capacity. A potential merger is under discussion among the associations. While understandably difficult, uniting both entities, as was done in Finland, would build mass and enable the new entity to be a stronger partner for all levels of government.

Conclusion

Operating successfully as a single government carries a series of implications, requirements, and potential benefits. First of all, it involves sharing resources across the public administration in order to increase efficiency. This is particularly important in the context of a small state where human resources may be scarce, and at a time where financial capacity is constrained. Estonia is moving in this direction at a central government level with back-office initiatives to strengthen and streamline human and financial resources in order to better serve ministries and agencies, allowing them to concentrate resources and efforts on policy design and implementation rather than on administration and operations.

Secondly, a single government approach involves supporting interoperability in terms of data and systems, either through consolidation or through aligning standards. New technologies such as the X-Road system, also allow disparate systems to share information with one another. Greater alignment permits the government to quickly and effectively access and share information, thereby improving workflow, as well as better serving citizens and businesses. Here too, efforts are underway through shared services and legal requirements to ensure the interoperability of databases.

Thirdly, shared tools and processes *(e.g.,* service level agreements, evaluation methodologies, training handbooks, electronic service delivery platforms, and electronic identification, etc.) help public sector bodies fulfil their functions more quickly and easily, prevent them from "reinventing the wheel," and ensure that they are all working in the same way. While a robust ICT infrastructure is in place, other administrative practices seem to rest more in the informal domain in Estonia, and this seems to be an area where more improvements and potential payoffs can be gained.

Finally, by putting citizens and businesses first, a public administration working as a single government is able to develop better policies, and to prioritise across its action areas in order to strike a balance between available resources and citizen preferences. There is an increasing trend among governments seeking greater effectiveness and efficiency to adopt whole-of-government mechanisms as a means to reduce fragmentation and break down strong silos often built as a result of "single-purpose organisation" models. Thus, a single government approach often requires a government to redefine itself both structurally and culturally.

Estonia's government appears to be ready to take a critical look at how it is structured and how it functions. Operating as a single government will necessitate further leadership within the public administration, as well as focus by the political level on the strategic leadership of the Cabinet. Action also needs to be taken to increase capacity for horizontal and vertical co-ordination, collaboration and co-operation. This would entail greater clarification of roles, responsibilities, and objectives, and ensuring that the mechanisms to realise government priorities function in a cohesive manner. Culturally within the Estonian public administration there is currently a tendency towards competitiveness and "doing it alone" (*i.e.*, to not depend on others in order realise goals or to pool means).

In addition, Estonia depends heavily on informal networks and individual leadership. These will need to be balanced with more institutionalised networks and methods of network governance that can outlast individuals. The strength of Estonia's network activity should be captured and channelled to support establishing and meeting whole-of-government goals rather than building silo-ed objectives. It is evident at the sub-national level, as well as at the central level, where collegiality is less highly valued than independence by public servants. This is antithetical to a single government approach and is one of the key cultural or values-driven characteristics that will need to be overcome if Estonia wishes to successfully move in this direction. Communication among key players, internal and external stakeholders, becomes essential for the development and implementation of policy within a whole-of-government context. Thus, in Estonia, improved communication capacity (both internally and externally) will be required.

Despite the difficulties of changing the structures and culture of the public administration, the potential benefits of a single government approach for all levels of government are significant. Improved citizen satisfaction – and therefore government

legitimacy – is top among them if collaboration is organised around citizen needs in policy development and in service delivery. Estonia is experimenting with more seamless service delivery through co-localisation and multi-purpose organisations. As a small state, such a move takes advantage of Estonia's experience and comfort with multifunctionalism in organisations and their activities, and can lead to greater responsiveness in serving citizens. In addition, social innovation – key to a government's overall innovative capacity – may be enhanced if whole-of-government frameworks are designed to permit greater innovation and creativity in defining, designing and implementing policy initiatives.

In looking towards a single government approach, Estonia is reinforcing its position as an innovative and forward-looking country. As this is a long-term endeavour, now is the time to begin evaluating what is required and building the societal and governmental agenda to meet this objective. Estonia has started moving along this path by taking steps to strengthen the Centre of Government, evaluate how to better link goals to resources, and identify techniques to bridge co-ordination gaps at all levels of government. While many elements of a single government approach are in place or being established, more could be done to develop them further and ensure their use. This includes public administration reform that fosters greater flexibility; promotes improved decision making; clarifies priorities, responsibilities, and accountability; and helps build the capacity of the public administration at all levels of government.

Key recommendations

Promoting a "whole-of-government" approach in public administration

I. Enable horizontal co-ordination by clarifying accountability in cross-sectoral initiatives and ensuring the work is sustained over time.

   A. Strengthen the stewardship role and capacity of the Centre of Government to build agreement around strategic priorities and to identify and enable leaders within the public administration to develop and deliver on horizontal policy initiatives.

      i) Enable the Centre of Government to negotiate horizontal objectives within the ministerial Organisational Development Plans, in order to ensure these are in line with the Government Programme and Horizontal Strategic Documents, to identify partners for the delivery of such objectives, and to ensure consistency across Organisational Development Plans in terms of responsibilities/ contributions and expected outcomes.

      ii) Enable the Centre of Government to endow a clearly established leader for each cross-sectoral initiative with decision-making authority and co-ordination responsibility. Provide the frameworks, incentives and support necessary for establishing shared responsibility on outcomes *(e.g.,* clear mandate, resources, legislative changes if necessary, etc.).

      iii) Strengthen the communication and co-ordination role of the Centre of Government to ensure that State bodies understand their individual roles with respect to meeting horizontal priorities, while also ensuring that they are aware of and responsive to shared responsibilities and outputs.

         – Use Estonia's capacity to mobilise networks to facilitate inter-institutional (ministerial, agency, etc.) co-ordination of sectoral policies in line with a common agenda and with the Government objectives.

- Develop incentive structures (*i.e.,* sanctions and rewards) to better ensure alignment of sectoral strategies with a common agenda and Government objectives.
- Identify and lead measurement mechanisms that can communicate success to the broader public and articulate areas for continued focus. Ensure that cross-cutting priorities are not crowded out by sectoral-specific targets.
- Lead the communication of a common agenda and Government objectives in order to build and renew commitment and accountability. This can entail identifying milestones and communicating when they have been reached.

iv) Lead and monitor performance measurement for horizontal priorities (at the central and sub-national levels) as part of an overall performance management system, and as a means to reinforce whole-of-government activity, to facilitate the dissemination of information within government, and to improve strategic effectiveness.

v) In order to link resources with realising horizontal outcomes, identify costs and funding sources associated with achieving horizontal priorities to be supported by the Organisational Development Plans.

B. Ensure line ministries take responsibility and are accountable for horizontal priorities; promote sharing performance information in order to support formal and societal accountability.

i) Maintain collective responsibility for shared outcomes by jointly establishing clearly articulated and delineated tasks, milestones and deadlines in the ministerial annual Action Plans; establish accountability mechanisms to the Centre of Government *(e.g.,* performance frameworks and agreements, and annual reports).

ii) Define shared responsibility for high-level outcomes that require the participation/activity of multiple ministries in Organisational Development Plans. Mechanisms can include bodies or working groups that could be tasked with delivering plans or establishing actions.

iii) Promote societal accountability for outcomes as a means of holding the actions and decisions made both formally and informally up to societal and parliamentary scrutiny.

C. Clearly define expectations and delineate responsibilities at the political level among relevant ministers, and between the political and administrative levels.

i) Better embed the Government Programme as a formal articulation of government priorities that cascades down from the political to the administrative levels, providing a basis for performance budgeting and management.

II. Strengthen responsibility for and practice of co-operation in the public administration by supplementing informal and personal networks with institutional ones.

A. Strengthen the formalised Secretaries General (SG) network to promote inter-ministerial co-ordination and co-operation. This should also be a forum to develop new ideas and solutions, identify policy synergies, build dialogue and exchange information. Over time, this group should take on shared responsibility for delivering on horizontal priorities.

B. Strengthen networks and/or communities of practice for Deputy Secretaries General (DSGs) in order to promote common understanding of horizontal policy issues at this level and to foster co-operation opportunities as they arise. Institutionalise dialogue, communication and exchange beyond personal networks and relationships. Eventually extend this concept to Department Heads.

C. Establish formal co-ordination mechanisms for the design, development and implementation of policy initiatives.

i) Co-ordination mechanisms can include regular meetings, establishing and circulating agendas, and disseminating outcomes and decisions to group members (and other relevant stakeholders when appropriate) in a written format to help establish a group understanding of the decisions taken, activities required, and responsibilities for action.

ii) Identify opportunities within the current government structure to pilot initiatives that build institutional networks around priority horizontal issues.

iii) Develop a communications and project plan for each initiative in which roles and responsibilities for co-ordination and communication are established between co-ordination group members.

III. Create a supporting organisational culture for horizontal ways of working.

A. Improve government communication internally and externally with respect to vision, expectations, reform, etc. Ensure that all key officials in the public administration have more detailed, broader and common information on the background/rationale of Government objectives.

i) Improve internal communication through the communication role of networks at all levels *(e.g.,* SGs, DSGs, etc.)

ii) Improve communication to citizens by making the citizen consultation portal more "user friendly" *(e.g.,* in terms of format), and establishing links from ministry/agency websites to such information.

B. Support, develop and embed public service values to build a common public service culture as a major tool to promote individual performance and whole-of-government methods of working.

i) Examine the appropriateness of existing public service values for achieving a whole-of-government approach and their alignment to a long-term vision for the public administration. Provide a forum to enable public sector staff to give feedback and submissions regarding public service values and regularly survey staff regarding perceptions of public service values.

ii) Enshrine whole-of-government public service values in the *Public Service Act* and embed these values in HRM practices, including: recruitment and selection; training and development; and performance assessment and management.

iii) Devise and implement a communications strategy, and develop communications material, for the roll-out of the renewed public service values throughout the public administration. Included in this should be a strategy for the ongoing communication of the values to embed these within the culture and every day operations of the public administration as well as training for existing and new staff.

iv) Support whole-of-government values through corporate leadership training.

C. Develop and channel existing public administration leaders at all levels of government as a means to support whole-of-government working methods and objectives, to be agents of change in their organisations, and to communicate across the public administration.

i) Use the formalised Secretaries General network to build individual responsibility for collaboration, solidify leadership and accountability at the senior level, and as a means to lead-by-example.

ii) Increase the emphasis on whole-of-organisation thinking and working in the Competency Framework of the Estonian Senior Civil Service; extend the framework's reach over time to other categories of staff, and build incentives through performance assessments to motivate participation.

iii) Emphasise and facilitate leadership training for the public administration at all levels of government, including local authorities, as a means to build administrative capacity, and to begin generating greater trust and common understanding between actors at different government levels.

D. Implement individual staff performance management systems across the public administration.

i) Establish an individual staff performance assessment and management framework as a base level across the public administration, which can then be adapted/tailored for use within individual agencies. Individual performance assessment criteria should include measurements for evaluating strategic thinking, innovative working, collaboration and co-operation, analytical capacity, and leadership. Ensure individual staff performance assessments are used as a mechanism for constructing and implementing staff learning and development plans.

ii) Link individual staff performance objectives to organisation objectives and outputs, to government outcomes, and to public service values. Organisation objectives should be filtered down through management and teams and should be in line to achieve government outcomes.

iii) Individual staff performance plans should have measures and be linked to pay advancement to ensure accountability for the achievement of results.

iv) Formal performance frameworks should be instituted in all public sector organisations with clearly communicated policies and procedures. For this to succeed, a public administration-wide initiative is needed to provide training to management and HR staff in managing the process, and to provide general training to all staff as a means to raise awareness of the framework, what is expected of the staff, and the process that will be undertaken.

IV. Build a flexible public administration.

A. Improve the independence of the public administration by clearly delineating responsibilities and functions of the political and administrative levels in order to allow the public administration to better manage resources in a whole-of-government manner and to better support government objectives.

i) Amend the *Public Service Act* to devolve responsibility for the daily management of the public administration from ministers to ministry/agency heads, for example in the areas of salary frameworks, recruitment and selection decisions, and position and movement of staff internally and across organisations.

ii) Clearly establish the roles and accountability structures for Deputy Secretaries General (DSGs) in managing the public administration, and in policy design and implementation; increase DSGs' decision-making responsibilities as part of the ministry management structure.

B. Taking into account demographic developments and other wider trends, develop a strategic and long-term view for the entire public administration and for the management of its institutions and personnel, and monitor implementation via a central body. Designate a responsible body for the development of the public administration and ensure stronger political commitment.

i) The responsible body for the development of the public administration should develop a shared whole-of-service vision for the management of the public administration.

C. Utilise workforce planning and undertake capability assessments within individual public sector organisations and policy areas and across the whole-of-government to ensure the right staff with the right skills are in place to deliver the government's agenda now and into the future. Ensure that government priority policy areas are covered with sufficient policy staff. Link these activities to recruitment and training programmes.

i) Embed workforce planning within and across public sector organisations linking it to the overall needs of the whole-of the public administration. Regularly monitor and update workforce planning activities at the whole-of-service level and better capture HR data within organisations and report it to a central area for analysis *(e.g.,* the Public Administration Department within the Ministry of Finance).

ii) Undertake capability assessments of skills and capacity gaps within public sector organisations against existing government priorities and anticipated future needs. Develop a whole-of public service profile. Link internal organisational training and any common skills gaps to be delivered centrally for the whole of the public administration.

iii) Expand the succession management programme, Newton, to include possible future leaders, and not just those identified as being immediate replacements.

iv) Use recruitment and selection criteria to assess a wider set of skills and experience, not just in one skill area.

D. Modernise and harmonise public sector remuneration while maintaining flexibility and also bring in needed skills from the market; make roles and responsibilities clear for each position; build transparency, and simplify processes.

i) Amend the existing *Public Service Act* to devolve responsibility for establishing salaries to heads of organisations (where salary frameworks are established in consultation with the Ministry of Finance).

ii) Develop and agree on a standardised salary classification system to be rolled out across the state administration. Starting with senior leadership positions, develop position descriptions regarding expectations at each classification level (rather than at the individual level). Over time, roll this out to all levels of staff.

iii) To increase the transparency of recruitment and salary decisions, establish mandatory open competitions based on merit and a vetting body within the public administration responsible for ensuring the fairness of recruitment

decisions and pay negotiations. Ensure that all recruitment advertisements include salary information and publish salary classification information on organisation websites.

iv) Simplify the formula used to calculate individual salaries.

E. Establish rotation and secondment schemes across all classification levels to improve the mobility of public sector staff; a staged roll-out beginning with senior management could be envisioned.

i) Implement a system for staff rotation and a secondment programme accessible by all levels across the public administration, not just senior management. Senior management rotations should be compulsory *(e.g.,* for a period of approximately three to five years per rotation).

ii) To enhance mobility of staff with the public administration, avoid creating two classes of public sector employees.

F. Continue rolling out the Shared Support Services initiative in order to enhance the efficient and effective delivery of corporate services.

i) Manage the sequencing and timing of implementation, including a capacity-building preparatory phase, as a means to learn from the evaluation and feedback of pilots, to develop skills and create communities of practice.

ii) Extend the Shared Support Services concept to other service areas, such as real estate administration, public procurement, etc.

iii) Build support for implementation including through improved co-ordination with other administrative service areas *(e.g.,* ICT, human resource management, financial management, etc.).

V. Take a whole-of-government approach to state public administration.

A. Amend the *Government of the Republic Act* to enable machinery of government changes to be made via administrative orders set by the government at the start of, or during, a parliamentary term to best deliver on government priorities and to meet citizen needs.

B. Utilise taskforces made up of Centre of Government, relevant portfolio ministry(-ies) and agency staff to work on new, priority, or emergent issues. Devolve responsibility for the issue to the appropriate ministry after an initial establishment period.

C. In the short term, use existing authority (*i.e.,* Sections 47 and 59 of the *Public Service Act*) to facilitate the movement of staff within the public administration based on the needs of the government as a whole. Over the longer term, make mobility an explicit objective as part of establishing whole-of-government public administration frameworks.

Building a common agenda

I. Construct a common societal agenda for Estonia in order to build support for reform.

A. Build stronger grounds for society-wide discussions on common long-term objectives for the country.

B. Develop anticipative capacity and foresight skills in the public administration to enable a broader capacity to look to the long term (20+ years).

C. Ensure that the method or approach used to develop the common agenda is inclusive (*i.e.,* engages at some level, politicians, civil servants at all levels of government, and citizens/civil society), but does not become just a paper-based strategy. Communicate the agenda to the political and administrative levels and citizens.

   i) Develop the vision through consultation and ensure that the message is well established in the public administration and embodied in the public administration's activities, culture and values, and communicated through government action.

   ii) Clearly communicate agenda and actor roles to the political and administrative levels as well as to citizens.

D. Link elements of the common agenda with Government objectives and to Organisational Development Plans to support the implementation of the agenda.

E. Further develop and promote the use of societal indicators for the measurement of progress and to identify areas for adjustment; improve timing and content of reporting back the results to the political and administrative spheres as well as citizens, on an appropriately timed and regular basis in order to build societal accountability.

II. Change organisational culture and individual expectations for pro-active, results-based work through the introduction of performance measurement and budgeting.

A. Set in place a politically led process to identify priorities across government for the next major round of strategic planning. Link this exercise with medium- and long-term budget frameworks to ensure that ambitions are realistic (or to identify spending challenges to be met), in order to oblige the prioritisation of programmes and spending.

B. Introduce a performance budgeting system to capture performance information in order to improve expenditure control, and public sector efficiency and performance. Define performance parameters to better steer spending and allocations, and to monitor the achievement of results.

   i) Manage the sequencing and timing of any implementation of a performance budgeting rollout, including a capacity-building preparatory phase, in order to learn from the evaluation and feedback of pilots, develop skills and create communities of practice, and to strengthen indicators and data sets.

   ii) Use the resulting performance budgeting system as a basis for dialogue between ministers and the public administration, between ministries and agencies, and among individual staff members to clarify performance expectations and to align organisation responsibilities with broader government objectives.

C. Develop a clear costing methodology for the Public Administration and continue the work started to standardise financial data.

   i) Improve the use of reporting information to track government revenue and expenditures, and use horizontal budget reviews to inform resource allocation/re-allocation, and incorporate this information into the budget decision-making process to increase the efficiency and effectiveness of public sector outcomes.

D. Establish incentives at the Ministerial and senior administrative levels to enhance the achievement and accountability of results.

III. Strengthen the decision-making framework at all levels by building in processes and expanding sources of information.

A. Formalise and streamline decision-making guidelines and processes to reduce rework, better utilise and focus resources, and communicate decisions and their rationale.

B. Develop evidenced-based decision making.

i) Build expectations within the public administration, Government and the Parliament for the use of evidence-based policy development and decision making.

ii) Develop the public administration's capacity to better undertake evidence-based decision making *(e.g.,* via training, inclusion in competency frameworks, mobility, etc.).

iii) Establish a framework for regulatory impact assessment (RIA) in the public administration.

iv) Improve internal and external dialogue to develop evidence bases as inputs to decision making in order to strengthen foresight and analytical capacity.

C. Improve, and then integrate, the use of citizen engagement practices at the concept stage of policy design to increase the effectiveness of policy outcomes.

Delivering public services effectively

I. Provide seamless and accessible services by developing a more coherent approach to public service delivery.

A. Create an enabling environment for standardising and co-ordinating service delivery across and among all levels of government (vertically and horizontally) by further aligning and/or consolidating administrative services at the central and sub-national levels.

i) Promote the overall efficiency and effectiveness of public services by strengthening the co-ordination efforts of transversal administrative services that impact service delivery *(e.g.,* e-government, data sharing), in particular across levels of government, and by ensuring that capacity is built to deliver the associated benefits.

ii) Promote vertical and horizontal collaboration in service delivery by reducing fragmentation of standards and approaches in administrative services through the creation of basic templates for common processes, decision making, and co-operation agreements; measurement methodologies, service level agreements; and harmonisation of ICT systems. Promote and support the use of contracts for vertical and horizontal co-operative initiatives (centrally and sub-nationally) in order to clearly establish aims and means for policy implementation, roles and responsibilities, lines of accountability, milestones and success measures.

iii) Promote the use of public sector networks and communities of practice in order to share problems and solutions, promote collaboration and build capacity at all levels of government, using a combination of real-time networking opportunities and ICT tools *(e.g.,* websites, wikipages).

iv) Better align platforms and standards as a first step towards centralising procurement and promoting further co-location of administrative services,

including establishing a common e-services platform development unit to provide technical development for both state and sub-national services.

v) Consider consolidating responsibility for central and sub-national public service delivery and administrative service activity into one organisation – either existing or new *(e.g.,* as seen in Australia, Canada, Denmark, Finland and the Netherlands).

B. Provide a clear mandate and responsibility for the alignment of relevant actors for all policies and services that affect service populations and/or end-users that share common needs or service delivery channels, in order to improve programme effectiveness by clarifying regulatory requirements, identifying cross-sectoral interactions and synergies, and keeping actors focused on objectives.

i) Expand the Lääne County "State House" concept to other regions; use the opportunity to reduce the number of administrative regions (see below); establish mechanisms to track internal-to-government efficiency gains.

ii) Rationalise and consolidate the number of ministry/agency actors at the sub-national level in service delivery by merging services and establishing fewer regional offices, but also ensuring that the services are all available as appropriate in the offices that are established *(e.g.,* seen in Finland).

C. Make services more user-focused by reducing information asymmetry and increasing transparency through the establishment of state and sub-national mechanisms to promote service quality *(e.g.,* accreditation programmes, licensing standards, service charters). Use such mechanisms as opportunities for communities to articulate shared ambitions for service quality at the local and national levels. This can provide the basis for the development of service standards as public expenditure levels rise, thereby providing guidelines for resource prioritisation and development.

i) Develop/expand national accreditation programmes for service providers (individuals and organisations).

ii) Establish national quality standards for the granting of licenses to establish and operate service-based facilitates *(e.g.,* residences and care homes for the elderly and/or disabled), which are applicable to both public and private operators.

iii) Increase sub-national authority and capacity to establish service agreements, and to monitor and enforce standards.

iv) Ensure that standards set are not minimum-quality standards that can result in a "race to the bottom" but rather are an incentive to improve service quality and effectiveness for all users, striving for a "race to the top".

D. Build central/sub-national performance measurement systems. Such a system could integrate performance evaluation measures, reporting structures and service quality standards.

i) Performance measures should be developed jointly with input from the relevant state ministries and agencies, and the national municipal associations.

II. Improve the efficiency of the state's presence at the sub-national level by integrating and rationalising county functions and administrative areas.

A. Review the role of county governments in order to build efficiency and scale in deconcentrated government activities, with consideration given to merging counties.

III. Match service delivery responsibilities to municipal type and capacity rather than adopting a "one-size-fits-all" approach.

A. Review service sets allocated to local authorities and establish minimum sets of service delivery obligations according to municipal financial, human and other resource capacities.

B. Ensure that the local services delivered, and the methods for delivery, match citizen needs according to municipal typology, capacity and need (rural, county-centre, urban, metropolitan).

i) Match urban and rural policy to service delivery challenges and opportunities *(e.g.,* establish Tallinn and its surrounding areas as a metropolitan region, or create a "Capital City" status for Tallinn to manage co-operative service delivery across municipal boarders).

ii) Build capacity in co-production and co-delivery of public services as a means to align services with citizen demands and needs.

iii) Facilitate alternative mechanisms of service delivery, such as public-private partnerships.

IV. Enhance sub-national service delivery by increasing municipal scale and capacity.

A. Establish mechanisms, including stronger incentives, under which non-integrated voluntary horizontal co-operation among municipalities becomes the *de facto* alternative to municipal mergers.

i) Provide central-level guidance and incentives (and sanctions) linked to clearly established (co-established) objectives (citizen satisfaction, effectiveness, quality, efficiency, etc.) to promote service area co-operation among municipalities.

ii) Establish a performance monitoring system for service areas in order to determine whether or not targets/objectives are being met, as inability to build capacity in service delivery through horizontal co-operation may require mergers.

B. For certain local public services where professionalism and scale is crucial for the quality of services, create a strategic fiscal framework with strong incentives for horizontal co-operation.

C. Mandate mergers as a next step for those municipalities where co-operation and voluntary mergers do not yield results that are based on clearly stated and communicated, measurable objectives.

i) Make sure clear territorial objectives are established, including: number of targeted municipalities, timeframe for selecting merger partners and submitting merger plans; timeframe for implementation of merger plans.

ii) Implement a strong incentive system that is structured around the number of municipalities merging and/or a target population level, when the merger takes place; consider developing a "bonus" for stronger municipalities to pair with weaker ones in order to prevent cherry-picking of partners.

iii) Ensure democratic participation in the selection of merger partners within established central-level guidance that prohibits municipalities from creating a "Swiss-cheese" effect or alienating smaller, weaker municipalities.

D. Experiment at the regional level to test the effectiveness of multi-service co-operation over a broad territorial area: *a)* for a pre-determined set of services, *e.g.,* transportation, upper secondary education, social services, water and waste management, water and energy provision, cultural heritage activities, etc.; and *b)* for catchment size.

E. Build sub-national financial capacity, including a possible local income tax, and ensure better coherence between equalisation and block grant systems. Develop fiscal or financial mechanisms to increase incentives for municipalities to improve service delivery and identify alternative ways to increase their "own-source" revenues.

   i) Consider a local income tax in order to give voters and tax payers more autonomy in their municipality and to enhance local democracy. In such an instance the tax base (and exemptions) could be centrally determined, and the tax rates set locally with a possible initial "band" for local tax variation, regulated by the central government, in order to avoid harmful tax competition.

   ii) Consider some adjustment to the equalisation grant and block grant systems by either separating cost and revenue equalisation, or by adjusting the current equalisation system.

F. Boost administrative capacity, particularly with respect to multi-level governance mechanisms, by strengthening common administrative processes and mechanisms, *e.g.,* contracts, co-ordinating bodies.

G. Strengthen the capacity of national- and sub-national-level co-ordinating bodies.

   i) National municipal associations should merge in order to build mass and capacity, and be a better partner for all levels of government.

   ii) Build capacity of county municipal unions to work with municipalities in service delivery including by re-evaluating and adjusting their legal status to facilitate their ability to take a more active role in delivering services to municipal members and their citizens, while remaining independent from the centre, and creating greater flexibility with funding sources *(e.g.,* funding in part by the central level and/or EU structural funds).

H. Adjust the method of EU funds allocation from a model of project-based competition to programme-based co-operation, in order to help shift the projects' focus from primarily infrastructure development to one where there is balance between investment in infrastructure as well as in human capital, capacity and innovation.

V. Build greater inter-ministerial/cross-disciplinary activity into the design, implementation and co-ordination of territorial, regional and local policy initiatives.

A. Establish a limited number of functional areas for regional planning to build critical mass for place-based regional development policies, to increase the effectiveness of regional policy planning on a national and sectoral basis, and to better support territorial development objectives and EU regional planning requirements.

   i) Establish functional territorial boundaries for regional planning purposes, grouping areas that demonstrate their own set of place-based characteristics.

B. Establish a clear hierarchy of linked territorial development plans, where the national spatial plan sets the stage for a national regional development strategy (using new functional regions as the basis) that also considers national-level sectoral

plans or initiatives with a regional dimension. Individual regional development plans should align to these, as should county and local development plans.

C. Use cross-sectoral, multi-disciplinary committees at the SG/DSG level, and a high-level Council to plan and co-ordinate regional policy, as well as public service delivery policy and programmes at the sub-national level.

D. Strengthen regional planning outcomes, including at the county level (county development plans), by ensuring a link to the State budget in addition to receiving EU funding.

Notes

1. Dependency ratio: Percentage of the population below 15 and above 64 years of age.
2. Working-age population: Population aged between 15 and 64 years.
3. "Personalism" of roles and functions is discussed in Chapter 3: "Public Governance Arrangements in Estonia".
4. Secretaries General and Deputy Secretaries General of Ministries, Directors General of Boards and Inspectorates, and County Governors.
5. It should be noted that the size of Estonia's public sector workforce is comparable with other countries. With a general government employment rate of 23% of the labour force, Estonia's share of public employment is similar to that of Finland and France, and within the top five OECD countries. Norway and Sweden have a share close to 28%; Finland, France and Estonia have a rate close to 23%; Hungary follows with a rate close to 19%.
6. Based on the five pillars of evidence-based decision making: political, research and technical, professional and practical, citizen, and the public administration.
7. The incentive structure is a "one time" EEK 3 million (approximately EUR 192 000) payment, and a formula that permits additional funds to be obtained based on the number of residents in a municipality. However, there is a ceiling.
8. A stepped, declining and temporary incentive structure was built into the PARAs model, where financial incentives to merge are higher the earlier the decision is taken and the higher the population figures of a municipality post-merger. Thus, for example in 2008-09, if the total number of municipalities reduced by a merger is three, creating a single municipality of over 20 000 inhabitants, and if the combined population of the two smaller municipalities deciding to merge is over 10 000, then the municipal merger grant is EUR 9.72 million. However, if these same three municipalities choose to merge in 2012-13, the grant falls to EUR 5.4 million.
9. 95% and 79% of responding countries (countries could respond to more than one mechanism). N = 19 (Charbit and Michalun, 2009).

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Towards a Single Government Approach
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Chapter 2

The Role of the State Following Economic Success

Since re-independence in 1991, and prior to the global financial and economic crisis, Estonia enjoyed one of the most dynamic periods of economic growth among transition and OECD countries. Today, Estonia faces the impact of the crisis together with other challenges threatening fiscal sustainability, including demographic decline and regional disparities. Many positive developments – including longer life spans, rising standards of living and European integration – will also raise new challenges. Over time, Estonia will need to continue to take advantage of its small size to remain strategically agile and to make the most of its national assets. This requires a public administration that is fit-for-purpose in terms of implementing the government's policy agenda, but that can also provide high quality analysis and advice, ensuring that longer term needs and perspectives are taken into account, and that can work as a single government in the service of citizens and business.

Table 2.1. **Basic Statistics of Estonia, 2009**

Land			
Area (km^2)	45 227	Major cities	
Agriculture, 2006 (%)	17	Tallinn, Jan 2010 (1 000)	399
Forest, 2006 (%)	49	Tartu, Jan 2010 (1 000)	103
People			
Population, (1 000)	1 324	Labour force, (1 000)	691
0-14 (%)	15	Employed, (1 000)	595.8
15-64 (%)	68	Agriculture (%)	4
65+ (%)	17	Industry (%)	32
Urban settlements (%)	68	Services (%)	64
Rural settlements (%)	32	Public sector (%)	27
Estonians (%)	69	Private sector (%)	73
Non-Estonians (%)	31	Unemployed (% of labour force)	13.8
Inhabitants per m^2	34		
Government			
General government expenditure (% of GDP)	45.2	Coalition government, as at Jan 2011	Seats
General government revenue (% of GDP)	43.4	Estonian Reform Party	31
General government deficit (% of GDP)	1.8	Union of Pro Patria and Res Publica	19
General government debt, Maastricht definition (% of GDP)	7	Total	50
Economy			
GDP, current prices (million EUR)	13 861	Origin of value added, 2008 (%)	
GDP per capita (EUR, current prices)	10 341	Agriculture	3
Gross fixed capital formation (% GDP)	21.6	Industry	29
Real GDP growth (annual)	–13.9	Services	68
Exports of goods and services (% GDP)	47	Imports of goods and services (% GDP)	52

Source: OECD (2011b, forthcoming), based on preliminary data from *Government at a Glance*, OECD, Paris; OECD (2010), *Statistical Database*, OECD, Paris; Statistics Estonia (2010), *Minifacts about Estonia*, Statistics Estonia, Tallinn.

Introduction

Since restoration of independence in 1991, and prior to the global financial and economic crisis, Estonia enjoyed one of the most dynamic periods of economic growth among both transition and OECD countries. GDP has grown rapidly in a transition economy environment, with rising employment and a well-controlled fiscal position. Critical to this success was Estonia's transformation from a centrally planned economy to a liberal market economy, and the state's role in navigating the country towards European Union (EU) membership. Government stewardship has resulted in budget surpluses, a judicious degree of openness, and a high level of economic and political stability, increasing its attractiveness for foreign investment. As a result, the Estonian government, supported by the public administration, is seen as a key orchestrator of economic development and a symbol for the successful democratisation process since re-independence.

In addition to the current economic downturn, Estonia is now facing a number of challenges which are threatening fiscal sustainability, including demographic decline and growing regional disparities. Many positive developments – such as longer life spans, rising standards of living, and European integration – will also raise new challenges. As Estonia matures, it will need to continue to take advantage of its small size to remain strategically agile and to make the most of its national assets. This requires a public administration that is fit for purpose in terms of carrying out the government's policy agenda; but that can also provide high-quality analysis and advice, ensuring that longer-term needs and perspectives are taken into account; and that can work as a single government in the service of citizens and business.

This chapter describes the economic and demographic context in Estonia. It highlights characteristics and policy approaches of Estonia's public administration, which are crucial to understanding Estonia's economic and social performance up to the global financial and economic crisis. An overview of the economic and social impact and response to the global financial and economic crisis will then be discussed in order to present new challenges. This will also provide the opportunity to review the operation of the public administration with the view to fine-tuning its operations to maximise its future efficiency and effectiveness. These will be explored in depth throughout the subsequent chapters of this report. In addition, this chapter:

- describes Estonia's key characteristics and successful economic policies leading to European integration;
- provides an overview of Estonia's economic and societal outlook;
- discusses the challenges threatening the sustainability of Estonia's fiscal position; and
- presents a rationale for reviewing the response of the public administration.

Estonia: A regained independence

Throughout its history, the Estonian identity, culture and forms of governance were strongly influenced by successive rulings of the German, Swedish and Russian empires. Before regaining independence in 1991, Estonia had little experience as an independent country. Foreign rule had been exercised since the 13th century, except for a 22-year span between 1918 and 1940. During this short inter-war period, the first Republic of Estonia was proclaimed. The numerous economic, social and political reforms undertaken strongly reinforced Estonian identity and allowed the Estonian culture to flourish. These structural reforms also contributed to its worldwide recognition as a sovereign state.

The Estonian economy and society as a whole suffered greatly from post-war Sovietisation. During the 50-year period of Soviet rule (1940-91), Estonia became subject to the Soviet Union's centrally planned economic system. As such, agricultural production declined considerably due to collectivisations and excessive taxation. The economy in general suffered from an almost complete nationalisation programme of the private sector, an over-valued currency and a fixed-price system, all of which distorted supply and demand mechanisms. Trade with other former Hanseatic League cities in Finland, Sweden and Germany was repressed and almost completely abolished. Instead, Estonia's economic production was re-oriented exclusively towards the Soviet Union. Rapid industrialisation was enforced, and factors of production were controlled and subsequently diverted from their optimum allocation. In 1939, Estonia and Finland had similar standards of living. By 1990, Estonia's real GDP per capita (measured in purchasing power parity) was less than half of Finland's, USD 6 438 and USD 16 446, respectively (UNDP, 1993).

Estonia had a smooth transition towards re-independence. The USSR's Perestroika in the early 1980s initiated a period of liberalisation, allowed the establishment of the Estonian Popular Front and set in motion the "Singing Revolution". Despite efforts from Moscow to strengthen its authority in the Baltic countries, the Estonian parliament declared the Estonians' right to sovereignty in November 1989. Over the next three years, Estonia gradually cut its economic and political ties with the Soviet Union and systematically lobbied, through its government-in-exile and foreign diplomats, for international recognition. Estonia declared full re-independence on 20 August 1991, during the attempted *coup d'état* in Moscow. The Soviet Union officially recognised Estonia's independence a month later.

Estonia between 1991 and 2010: Four stages of economic development

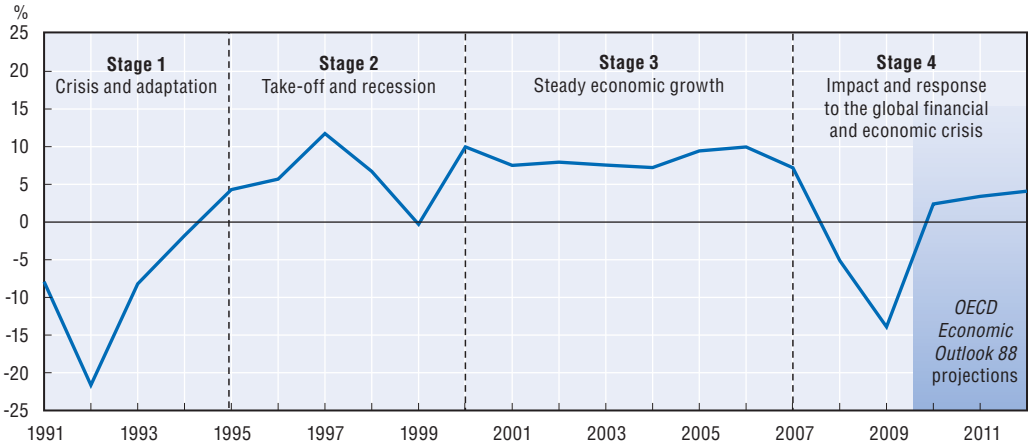
Since regaining independence in 1991, four stages of economic development can be distinguished describing Estonia's transition from a centrally planned system to a liberal market economy (see Figure 2.1).

- Stage 1 (1991-94): Economic crisis and adaptation.
- Stage 2 (1995-99): Economic take-off and recession.
- Stage 3 (2000-07): Steady economic growth.
- Stage 4 (2008-10): Impact and response to the global financial and economic crisis.

Estonia between 1991 and 2007: Adaptation and strong growth

The first four years of re-independence in Estonia was a period of crisis and adaptation. After the fall of the Berlin Wall and the subsequent disintegration of the USSR,

Figure 2.1. **1991-2010: Four stages of economic development**



Note: 1991-95 data from IMF *Economic Outlook Database 1999*. Figures have been revised since.
Source: OECD (2010) *Statistical Database*, OECD, Paris; IMF (2010) *World Economic Outlook Database*.

Central and Eastern European (CEE) countries faced new issues which needed to be addressed rapidly in order to lay the foundations for economic and societal prosperity. First and foremost was the choice of the most efficient institutional arrangements and effective economic policies. The collective opinion in Estonia was to urgently establish a constitutional democracy and a liberal market economy, not only as a means to abandon the centrally planned Soviet system but also to meet the requirements necessary for joining international organisations. Following presidential and parliamentary elections in 1992, the first elected government implemented structural economic reforms aimed at full market liberalisation and based on economic and political independence from the Russian Federation.

The price liberalisation programme was the first crucial reform. It also had high symbolic value as the inherited fixed-price mechanism was almost fully abolished by 1992. Other significant measures taken included monetary reform in 1992 with the adoption of the Kroon as the national currency. It was pegged to the German Deutschmark, mostly to restrain inflation. Many previously state-run companies were hastily privatised and regulatory incentives, though insufficient, were developed to stimulate the creation of new enterprises. However, not only did the economy lack sufficient financial resources necessary to create SMEs, but the initial macroeconomic instability – high inflation in particular – hindered foreign capital investment. In addition, the benefits from the liberal market reforms were not immediate, as economic agents needed time to adjust to new market mechanisms. Mostly due to structural flaws inherited from the centrally planned system, Estonia went through a severe economic recession during 1991-94, evidenced by the GDP's contraction of almost one-quarter in 1992. As a consequence, many Estonians saw their standard of living deteriorate considerably.

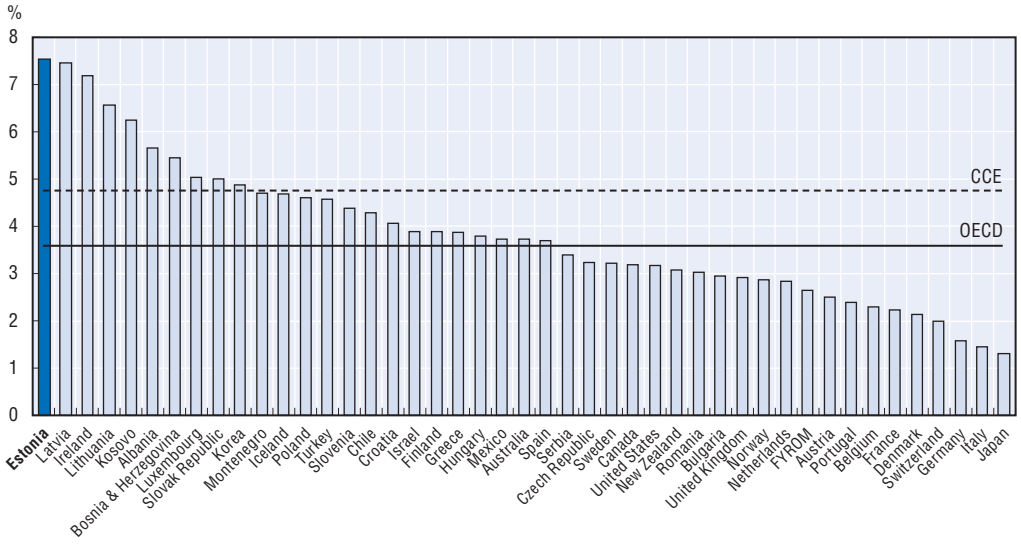
During the second half of the 1990s, the Estonian economy managed to stabilise itself and experienced growth for the first time since re-gaining independence. The liberal market reforms started to provide the incentives and stimulus necessary for economic growth to take off in 1995 and accelerate for three consecutive years, reaching 12% in 1997. The key reforms which guaranteed this success were the creation of a currency board, price deregulations, property-right reforms, privatisations, enterprise reforms and trade liberalisation. Production

mechanisms had therefore been re-oriented towards entrepreneurship, innovation and free trade. This ambitious programme took great advantage from trading with neighbouring countries, and eventually from globalisation.

CEE countries are often analysed as a group because of their common history. In addition, almost all of them implemented similar economic reforms necessary to join the European Union during the late 1990s and early 2000s. Estonia distinguishes itself through its economic success, as it enjoyed the fastest growth amongst OECD and CEE countries between 1996 and 2007, with an average annual rate of real GDP growth of 7.5% – far above the CEE average of 4.8% and over twice the OECD average of 3.6% (see Figures 2.2 and 2.3).

Figure 2.2. **Average annual real GDP growth in the OECD and CEE countries, 1996-2007**

Average annual growth rate in percentage

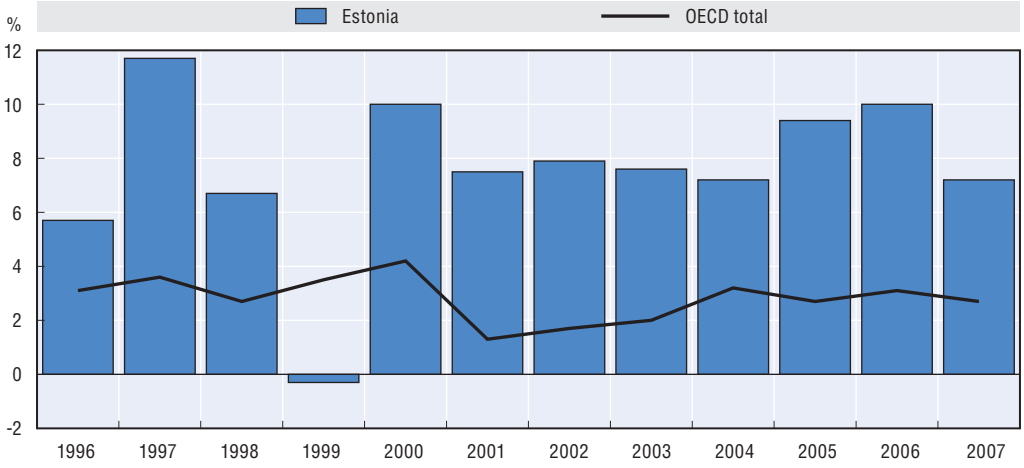


Notes: Annual percentages of Gross Domestic Product, constant prices (National currency). Data for Bosnia and Herzegovina and Serbia: 1999 instead of 1996. Kosovo and Montenegro: 2001 instead of 1996.

Source: OECD (2010), *Statistical Database*, OECD, Paris; IMF (2010), *World Economic Outlook Database*; OECD calculations.

Figure 2.3. **Real GDP growth, 1996-2007**

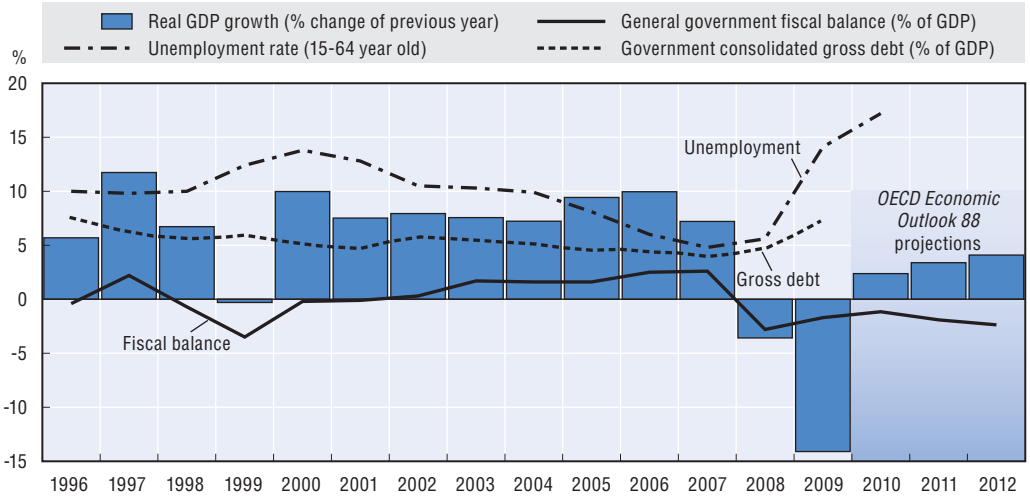
Annual growth in percentage



Source: OECD (2010), *Statistical Database*, OECD, Paris.

After a short recession in 1999 – mostly related to the Russian financial crisis – real GDP increased annually by more than 7% from 2000 to 2007. During this period of high economic growth, inflation was initially low and new jobs were created; the unemployment rate declined by as much as 9 percentage points, from 13.8% in 2000 to 4.8% in 2007 (see Figure 2.4). Most importantly, Estonia ran a public budget surplus for five consecutive years, from 2002 to 2007, accumulating assets amounting to approximately 10% of GDP. Partly by using the accumulated assets, public debt, measured as general government gross consolidated debt, was also reduced during the same period, from 5.1% in 2000 to 3.8% in 2007.

Figure 2.4. **Macroeconomic indicators, 1996-2012**



Source: OECD (2010), *Statistical Database*, OECD, Paris (Real GDP growth, fiscal balance); *Eurostat Databases* (government debt); and Statistics Estonia (2010), *Databases* (unemployment).

Concurrently, Estonia experienced the strongest increase in GDP per capita among OECD countries between 1995 and 2008. Though the lowest in 1995, it more than tripled in 13 years, from USD 6 280 in 1995 to USD 21 685 in 2008. As such, Estonia moved up the OECD rankings by six places, from last to 29th (see Figure 2.5).

Estonia in 2007-08: A small, open and competitive economy

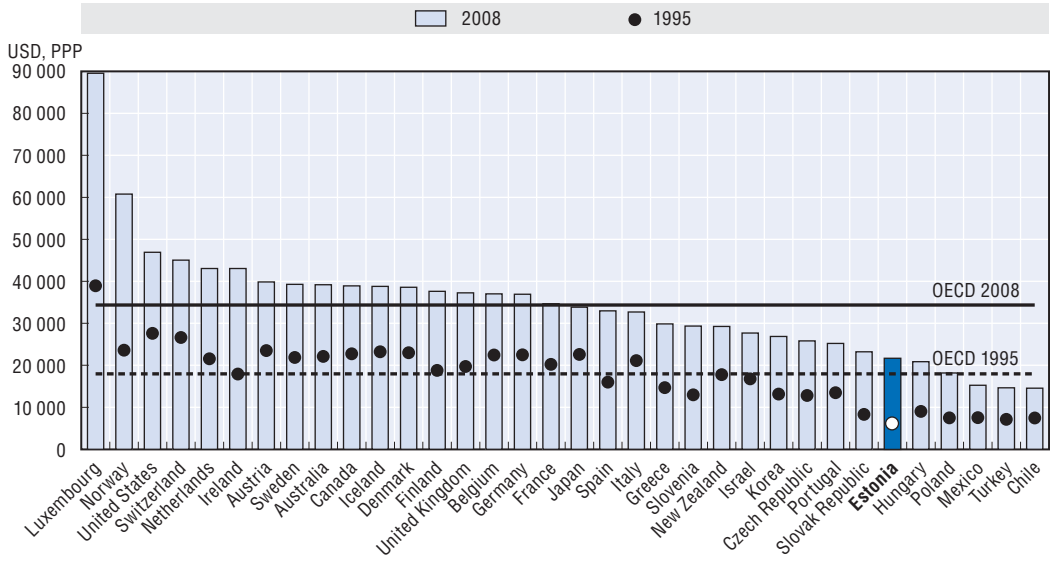
Following many years of strong growth, Estonia's economy has become very open and competitive. This has been necessitated by its small size and is also a function of political will. Upon entering the European Union in 2004, Estonia was widely recognised as having successfully completed its transition from a centrally planned to a stable market economy.

A small and open economy

Estonia is a very small country compared to OECD member countries in terms of both GDP and population. In 2008, it was the second-smallest OECD economy with a GDP of USD 29 billion. Only Iceland's economy is smaller (USD 12.4 billion). Luxembourg is the third-smallest economy, with a GDP almost 50% larger than Estonia's (USD 43.4 billion). In comparison, the OECD median-size economy (USD 343.8 billion) is almost twelve times larger than Estonia's. In terms of its demographic size, Estonia is the third-smallest OECD country with a population of 1.34 million in 2009. Only Iceland (470 000) and Luxembourg

Figure 2.5. **GDP per capita, 1995-2008**

USD, current prices, current PPP



Source: OECD (2010), *Statistical Database*, OECD, Paris.

(310 000) have smaller populations. Slovenia is the country just above in the population rankings, with 2.02 million people. In comparison, the OECD median of 10.62 million people is almost eight times greater than Estonia's population. In terms of geographical size, Estonia is the seventh-smallest OECD country with a land area of 45 000 km^2. It is slightly smaller than Slovak Republic (49 000 km^2) but marginally larger than the Netherlands and Switzerland (both 41 000 km^2), and Denmark (43 000 km^2). Belgium, Slovenia and Luxembourg are considerably smaller geographically than Estonia.

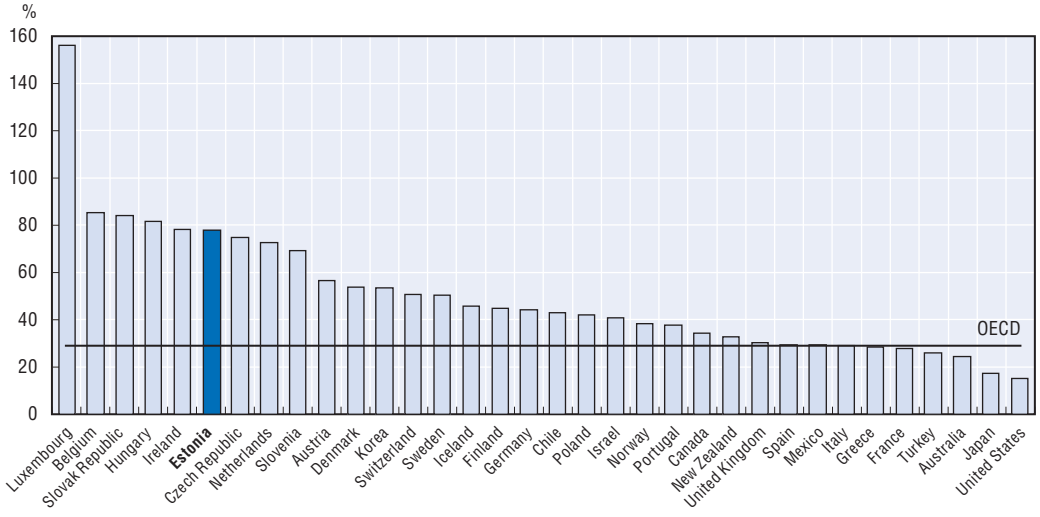
Due to its small size, geographical location and shared historical ties, Estonia shares some common approaches with Nordic countries, including openness to trade. Estonia's relatively small economy must overcome a peripheral location, a constrained resource base that limits the potential for economies of scale, and a resulting dependency on imports. This helps to explain Estonia's strong commitment to free-trade policy in the first decade of re-independence. It also stems, however, from a deeply rooted tradition, extending back to the 14-15th Century, when Tallinn, Pärnu, Tartu and Viljandi were members of the Hanseatic League. In its first decade of re-independence, Estonia's foreign trade policy was almost completely oriented towards free-trade to benefit from previously repressed international markets. As the country entered the EU accession process in the late 1990s, its trade policy became more regulated and moderate. Nevertheless, as of 2008, Estonia was the OECD's sixth most open economy with a share of international trade of goods and services representing 77.7% of GDP, compared to an OECD average of 28.9% (see Figure 2.6).

Economic openness has been accompanied by international economic integration, particularly in the manufacturing sector. Intermediate goods accounted for over half of foreign trade (57% of total exports, and 53% of total imports), as Estonia is part of the supply chain for the production of finished goods in the Nordic area. In 2009, the share of total exports towards Nordic countries was 38%, of which nearly half was towards Finland (see Table 2.2).

Estonia has a very low impact on price and supply levels in international trade markets due to its small economy and its poor endowment in natural resources. This has

Figure 2.6. **Country openness, 2008**

Share of international trade of goods and services as % of GDP



Source: OECD (2010), *Statistical Database*, OECD, Paris.

Table 2.2. **Foreign trade, 2009**

Percentage share of total

	Exports (destination countries)	Imports (countries of origin)
OECD	**66.5**	**63.0**
Of which:		
Nordic countries	37.8	26.6
Finland	18.6	14.6
Sweden	12.5	8.4
Denmark	3.4	2.4
Norway	3.2	1.3
Netherlands	2.5	3.7
Germany	6.1	10.4
United States	4.2	1.4
France	2.3	2.6
Poland	1.8	5.6
Baltic countries (Latvia and Lithuania)	**14.3**	**21.4**
Russian Federation	**9.3**	**8.2**
Rest of the world	**9.9**	**7.4**

Source: Statistics Estonia (2010), *Databases*.

obliged decision makers to design economic policies that take both internal and external objectives into consideration. Estonia has therefore a strong incentive to participate in supra-national economic policy design, and hence to seek membership in most international organisations, as it has done by securing WTO membership in 1999, European Union and NATO memberships in 2004, and joining the Economic and Monetary Union (EMU) by introducing the euro on 1 January 2011. In December 2010, it was the first Baltic state to become a member of the OECD.

A competitive business environment

Before the current economic recession, Estonia had one of the most competitive economies in the OECD. Foreign direct investment inflows were high, and more jobs and firms were being created than in most CEE countries. The OECD's product market regulation indicator highlights the effectiveness of competition-friendly regulatory reforms, but also the relatively high level of state involvement in some areas of the economy (OECD, 2009c). Financial markets developed rapidly during the years preceding the global financial and economic crisis. Most of the business sector's financing was provided by foreign banks and investors. Due to the booming real estate market, businesses in construction activities had easier access to financial resources compared to non-real estate market businesses, such as new and innovative SMEs.

Enterprise Estonia and *KredEx* are two government agencies which co-ordinate and implement the grants, loans and guarantee programmes aimed at easing the financial constraints faced by innovative and start-up businesses. In addition, they manage many different innovation and entrepreneurship programmes, which often overlap and create co-ordination problems. Furthermore, Enterprise Estonia is a major channel for EU Structural Funds into the business sector, as well as to local authorities. However, most of the Structural Funds made available for the 2007-13 period, representing approximately 4% of annual GDP, have already been "front-loaded" to alleviate the immediate impact of the economic downturn. This approach is in light of an expected rapid recovery from the effects of the global financial and economic crisis.

Economic activity distribution is similar to other OECD countries. In general, services account for approximately two-thirds of the country's total value added, industry for 30% and agriculture for less than 5%. More specifically, the economic sectors which contribute the most to GDP are real estate, renting and business activities (21.2% in 2009); manufacturing (14.5%); wholesale and retail trade, repair of motor vehicles, etc. (13.5%); transport, storage and communication (10.3%); and construction (6.8%) (see Table 2.3, columns on value added by economic activity). Almost all sectors were hit severely, though unequally, by the global financial and economic crisis. The most affected sectors were those which had experienced the strongest growth prior to the crisis: construction (–30.1% change in value added between 2008 and 2009), financial intermediation (–26.5%), and manufacturing (–25.8%) (see Table 2.3, columns on value added growth). Estonian enterprises provide the highest value added in the growth of GDP. Two-thirds of the value added created by enterprises are found in the four most important economic activities: manufacturing, trade, construction, and transportation and storage.

Regional disparities

Since regaining independence, Estonia's dynamic and productive centres have inverted, with economic activity shifting away from rural communities to urban ones. Regional disparities are evident when comparing economic activity, average monthly gross salaries and wages, and unemployment. While such disparities are not uncommon among OECD countries, they can strain the regional and local capacity to deliver public services. Economic activity (*i.e.*, contribution to national GDP) is most highly concentrated in Harju county (which includes Tallinn), at approximately 60%, where approximately 40% of the Estonian population is located (see Table 2.4). GDP per capita in the Harju County is therefore significantly higher – over 50% – than Estonia's average. The counties of Tartu and Ida-Viru are the two other main providers of domestic product, at 10% and 8% of national GDP,

Table 2.3. **Value added by economic activity**

Percentages

	Value added by economic activity			Value added growth[1]		
	2007	2008	2009	2007	2008	2009
Agriculture and hunting	2.2	1.7	1.6	18.6	–2.5	–10.2
Forestry	1.0	1.0	0.9	–18.6	7.6	16.6
Fishing	0.1	0.2	0.2	–2.9	5.6	5.8
Mining and quarrying	1.1	1.0	1.2	16.0	–8.5	–11.1
Manufacturing	16.9	16.7	14.5	6.2	–4.2	–25.8
Electricity, gas and water supply	3.0	3.2	3.7	11.2	–7.4	–12.0
Construction	9.1	8.3	6.8	11.8	–5.3	–30.1
Wholesale and retail trade; repair of motor vehicles, etc.	14.5	13.9	13.5	6.4	–8.6	–19.7
Hotels and restaurants	1.5	1.5	1.4	5.0	–7.9	–22.9
Transport, storage and communication	10.4	10.1	10.3	9.4	–4.1	–15.9
Financial intermediation	4.0	4.0	3.5	18.6	–2.9	–26.5
Real estate, renting and business activities	19.9	20.1	21.2	3.9	–0.5	–7.0
Public administration and defence; compulsory social security	5.6	6.4	7.8	2.8	6.8	1.4
Education	4.2	4.8	5.5	0.7	1.2	–4.1
Health and social work	3.2	3.6	4.2	4.1	–0.4	–2.3
Other community, social and personal service activities	3.3	3.5	3.6	2.8	0.0	–15.1
Value added total	100	100	100	6.7	–3	–15.2
Net taxes on products		10.8	–7.2	–5.4		
GDP at market prices		7.2	–3.6	–14.1		

1. Compared to previous year, chain linked, reference year 2000.
Source: Statistics Estonia (2010), *Databases*.

respectively. Although Tartu has the second-highest level of GDP per capita, three counties – Pärnu, Saare and Lääne-Viru – have a level of GDP per capita higher than Ida-Viru. Ida-Viru county has traditionally been a location for industry with lower value-added, such as in the textile industry. Economic activity is particularly weak in the counties of Põlva, Valga and Jõgeva, where GDP per capita is 50% lower than Estonia's average.

Economic activity has been mostly dynamic in Põlva and Harju counties, with 49% and 48% of gross GDP growth, respectively, over the 2005-08 period (see Table 2.4). Economic activity was sluggish in Hiiu county, with 22% of gross GDP growth during the same period. Average monthly gross salaries and wages are significantly higher in Harju and Tartu counties than in Valga and Jõgeva counties. Although the unemployment rate was above 10% in all counties in 2009, there were significant regional disparities (see Table 2.4 and Figure 2.7). The share of the labour force unemployed in Jõgeva County (20.1%) was almost two times higher than in Pärnu and Saare counties (10.6% and 10.4%, respectively).

2008-10: The impact and response to the global financial and economic crisis

By 2005, Estonia's economy was growing above potential, driven by internal demand and the confidence of highly optimistic economic agents. It therefore gradually started showing signs of overheating, as inflation gained ground, labour and skill shortages emerged, and current account deficits reached unsustainable levels. Estonia had been financing its extending trade deficit by borrowing on foreign financial markets, mostly via the real estate market. The overheating economy was therefore fuelled by foreign financial assets, primarily mortgage credits granted by Scandinavian banks mostly in Euros. These were used to fund non-tradable investments, particularly in the real estate market, leading

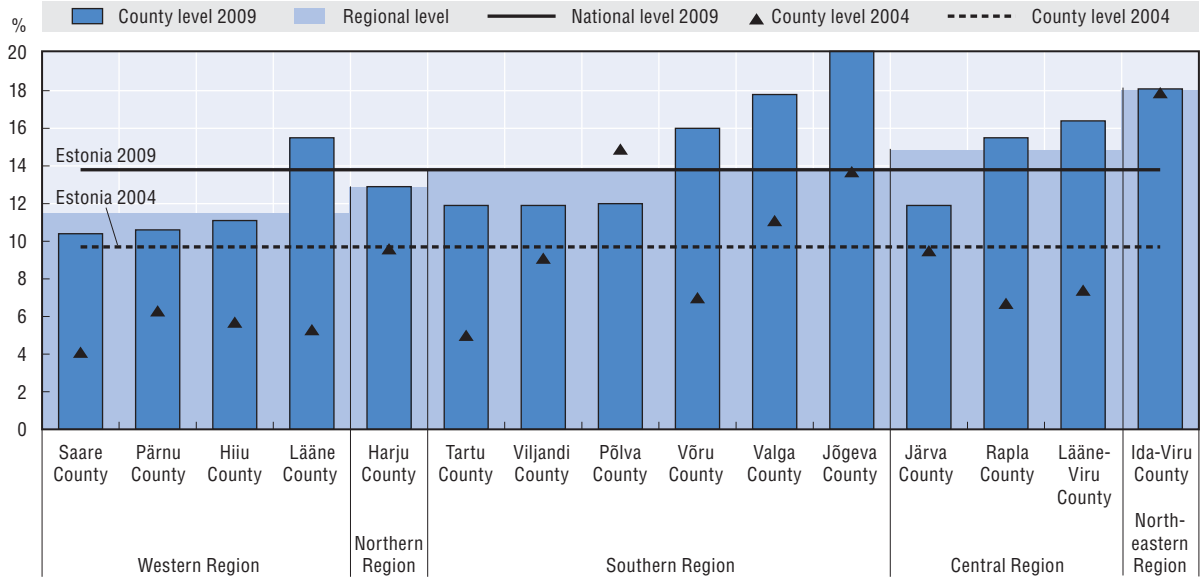
Table 2.4. **Regional disparities**

	Population (2010)	Share of total population (2010) (%)	Share of national GDP (2008) (%)	GDP per capita, % of Estonian average	Gross growth of GDP[1] 2005-08 (%)	Average monthly gross wages, % of Estonian average	Unemployment rate (2009) (%)
Estonia	**1 340 127**	**100.0**	**100.0**	**100.0**	**44.0**	**100.0**	**13.8**
Põhja-Eesti/Northern Region	526 505	39.3	59.6	152.9	46.7	112.7	12.9
Harju county	*526 505*	*39.3*	*59.6*	*152.9*	*46.7*	*112.7*	*12.9*
Lõuna-Eesti/Southern Region	344 822	25.7	17.7	68.8	41.9	n.a.	13.8
Jõgeva County	*36 671*	*2.7*	*1.2*	*43.1*	*36.4*	*73.8*	*20.1*
Põlva County	*30 889*	*2.3*	*1.2*	*49.7*	*49.3*	*81.7*	*12.0*
Tartu County	*150 074*	*11.2*	*10.4*	*92.9*	*45.6*	*95.6*	*11.9*
Valga County	*34 048*	*2.5*	*1.2*	*48.9*	*33.0*	*73.2*	*17.8*
Viljandi County	*55 447*	*4.1*	*2.3*	*54.7*	*31.1*	*82.1*	*11.9*
Võru County	*37 693*	*2.8*	*1.5*	*53.1*	*42.3*	*82.5*	*16.0*
Lääne-Eesti/Western Region	160 470	12.0	8.2	68.6	35.2	n.a.	11.5
Hiiu County	*10 032*	*0.7*	*0.4*	*58.6*	*21.9*	*77.4*	*11.1*
Lääne County	*27 366*	*2.0*	*1.2*	*60.8*	*37.5*	*79.0*	*15.5*
Pärnu County	*88 428*	*6.6*	*4.7*	*71.7*	*32.4*	*84.0*	*10.6*
Saare County	*34 644*	*2.6*	*1.8*	*69.7*	*45.1*	*83.2*	*10.4*
Kirde-Eesti/Northeastern Region	168 656	12.6	8.1	64.2	44.8	81.2	18.1
Ida-Viru County	*168 656*	*12.6*	*8.1*	*64.2*	*44.8*	*81.2*	*18.1*
Kesk-Eesti/Central Region	139 674	10.4	6.3	60.4	37.2	n.a.	14.9
Järva County	*36 058*	*2.7*	*1.6*	*57.9*	*34.6*	*79.8*	*11.9*
Lääne-Viru County	*66 996*	*5.0*	*3.4*	*66.9*	*41.2*	*79.6*	*16.4*
Rapla County	*36 620*	*2.7*	*1.4*	*50.7*	*31.1*	*81.8*	*15.5*

1. Gross growth of GDP based on current prices. County-level GDP is recorded by current prices only, thus annual changes do not consider annual price changes.

Source: Statistics Estonia (2010), *Databases*.

Figure 2.7. **Unemployment rates at the national, regional and county levels, 2004 and 2009**



Source: Statistics Estonia (2010), *Databases*.

to a property bubble. Foreign financial assets had been entering the country with great ease, not only because of favourable financial liberalisation measures implemented as a request to join the EMU, but also because Estonia's financial markets demonstrated strong credibility due to successive government fiscal surpluses. Estonia's attractiveness to foreign assets was based on the assumption of EMU membership. With the property market bubble on the verge of bursting by the end of 2007, and foreign capital flowing out of the country early 2008, Estonia had to find new ways of financing its trade deficit.

In 2008, the Estonian economy entered a recession, mostly triggered by declining real estate prices and construction activity. By the end of the year, real GDP had contracted by 3.3% (see Figure 2.4). Twelve months later, domestic demand fell by almost one-quarter, and along with the decrease in external demand due to the global financial and economic crisis, the Estonian economy experienced its worst recession since re-independence: a 14.1% decrease in real GDP. Furthermore, Estonia's foreign trade contracted considerably in 2009, as total exports decreased by almost one-quarter compared to 2008, and imports by one-third. Nevertheless, while the flexible nature of the economy is one reason why Estonia was strongly hit by the global financial and economic crisis, greater flexibility has also permitted Estonia to adapt and respond quickly to the crisis.

Estonia's response to the global financial and economic crisis has been a good example of its ability to move resources in response to a crisis situation. As internal demand began to slow towards the end of 2007, Estonian authorities began designing policy measures aimed at circumventing the impact of a potential internal recession. Although these measures were initially difficult, and managed only to minimise the impact of the recession, they placed Estonia in a relatively favourable position when the country was hit by the global financial crisis a year later. Because of the policies aimed to counter-balance the internal economic slow-down, Estonian authorities were well placed to respond to the global financial crisis by further improving and consolidating these measures already underway.

In the end of 2008, as the global financial and economic crisis spread to the real economy, and in response to an expanding fiscal gap, the Estonian government revised the 2009 budget. Two supplementary budgets and a budgetary amendment representing 9.3% of GDP were passed in 2009, of which approximately one-half concerned expenditure, including decreases in social benefits, consolidation of public functions, and a half-percentage point reduction in the rate of personal income tax re-distributed to municipalities. Increases were also made to VAT and excise duties.

The first two restrictive supplementary budgets passed in 2009 had the ambition to reduce public expenditure by 5% and improve the overall public balance position by over 9% of GDP. Measures included:

- a 10.6% cut in operational expenditure by the central government;
- a reduction in the annual pension planned increase from 14% to 5%;
- various tax increases (value added tax from 18% to 20%; including bringing forward fuel and tobacco excise taxes, and natural gas); and
- an increase in the unemployment insurance fee to ensure financial sustainability of the Unemployment Insurance Fund.

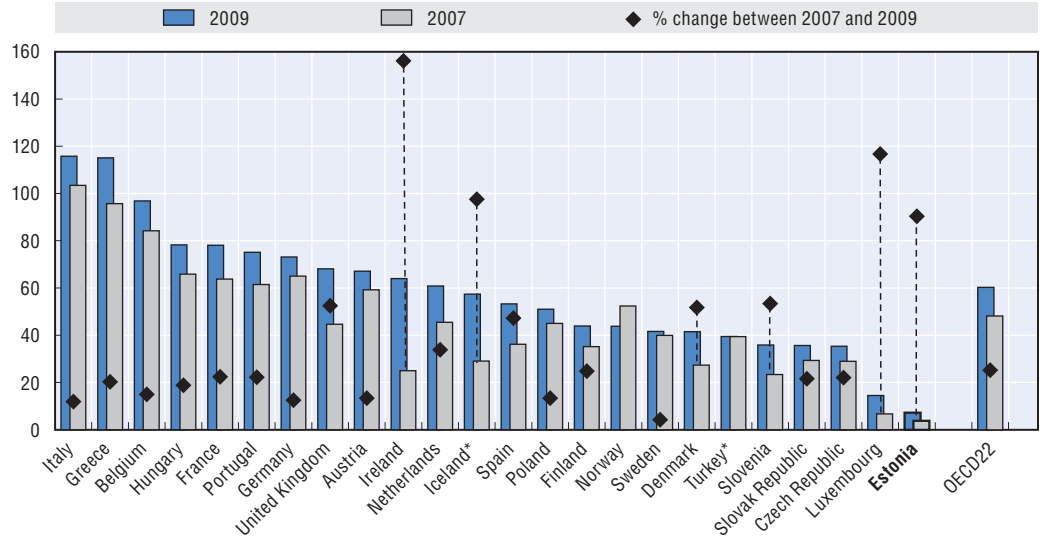
While many of these measures were painful, by the second half of 2009 support for the government had risen – even in the face of austerity measures.

Estonia's public finances

In 2009, Estonia's public finances were in a significantly good position compared to most OECD countries, as the overall public budget deficit stood at 1.7% of GDP and public debt represented only 7.2% of GDP (see Figure 2.8). In 2010, exports increased by 35% on an annual basis, buoyed by rising external demand. In 2010, Estonia's economy recovered moderately. Though inflation returned slightly sooner than expected and unemployment remains high, the economy is forecasted to gain momentum in 2011, when growth rates are expected to reach 4%. The government is aiming to return to a balanced budget by 2013.

Figure 2.8. **General government debt, 2007-09**

% of GDP, Maastricht criteria



Source: Statistics Estonia (2010), *Databases*.

Public debt

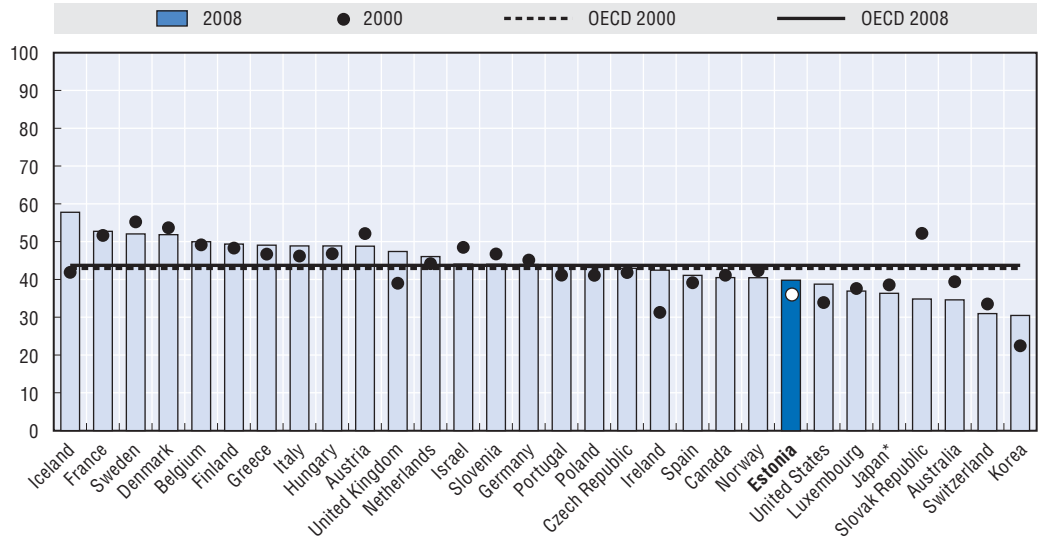
Entering into the global economic crisis in 2009, Estonia's level of public debt (according to the Maastricht criteria) was lower than any other OECD-EU member country (see Figure 2.8). Debt represented 7.2% of GDP in Estonia, compared to an average of 60.2% for 22 OECD member countries. However, it experienced the fourth-largest increase in public debt between the eve of the global financial and economic crisis in 2007 and 2009, with a 90.4% increase in nominal terms. In addition, Estonia's level of private debt remains significantly higher than its public debt.

Public expenditure

Budget discipline in Estonia has been achieved through policy prioritisation. Estonian public expenditure as a percentage of GDP is in the lower range compared to other OECD countries (see Figure 2.9). However, Estonia's public expenditure increased faster than most other OECD countries between 2000 and 2008 (see Figure 2.10).

Figure 2.9. **Share of government expenditure, 2000 and 2008**

% of GDP

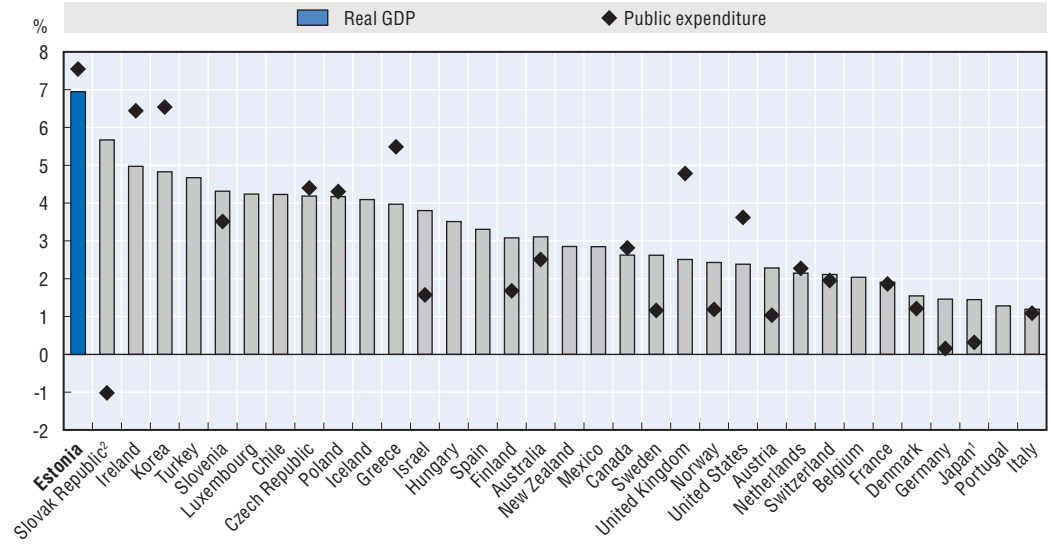


Note: Calculations based on national currency, current prices, total government expenditure and GDP output approach.

Source: OECD (2010), *Statistical Database*, OECD, Paris.

Figure 2.10. **Real GDP and public expenditure growth, 2000-08**

Average annual rates of growth



1. Japan: public expenditure 2000-07.
2. Slovak Republic: public expenditure 2000-06.

Source: OECD (2010), *Statistical Database*, OECD, Paris; *Eurostat Databases*, Australian Bureau of Statistics, Canada Statistical Portal.

Social performance

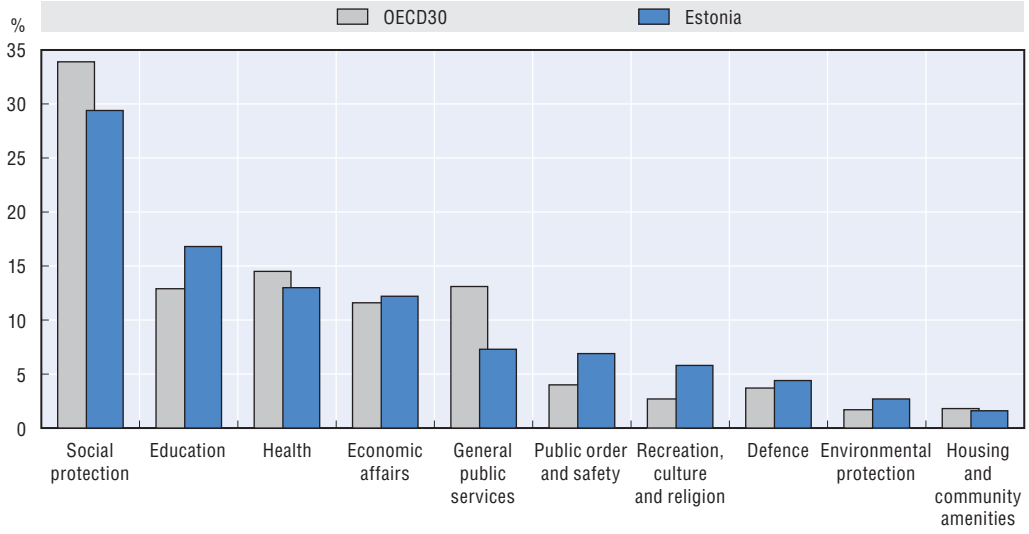
Due to a liberal economic orientation and prudent fiscal discipline adopted by the first administrations, social policies have been a second priority for Estonian governments. Social policies have focused more on work incentives rather than on re-distributing incomes through cash and in-kind transfers (OECD, 2010o). Estonia's public social spending

relative to GDP is among the lowest in the OECD. The EU accession process, underlined by promotion of social values, has brought some progress in this area. The country has very generous parental benefit schemes, designed to promote female labour force participation as well as birth rates. The relatively high employment rate in older age groups makes the country well-prepared for the expected ageing population. However, although improvements have been made, most pensioners are near, if not below, conventional poverty limits (OECD, 2010o). Nevertheless, a solid institutional and economic foundation underscored by a national eagerness to strive towards prosperity has served as a good basis for eventual convergence with European standards.

Estonia spends almost five percentage points less on social protection than the OECD average, in terms of total general government expenditures (see Figure 2.11). However, the public sector still holds an important role in social protection, which is the highest function of public expenditure (29% of total general government expenditures), followed by education (17%) and health (13%). Estonia is the third OECD country to allocate the largest share of its government expenditures to education, with 16.8 % of total general government expenditures, behind New Zealand (18.8%) and Canada (18.3%). The success of the educational system is demonstrated by Estonia's good performance in the latest OECD PISA rankings, where it ranks fifth among OECD countries in the mathematics scale (see Figure 2.12).

Figure 2.11. **Structure of general government expenditures by function, 2008**

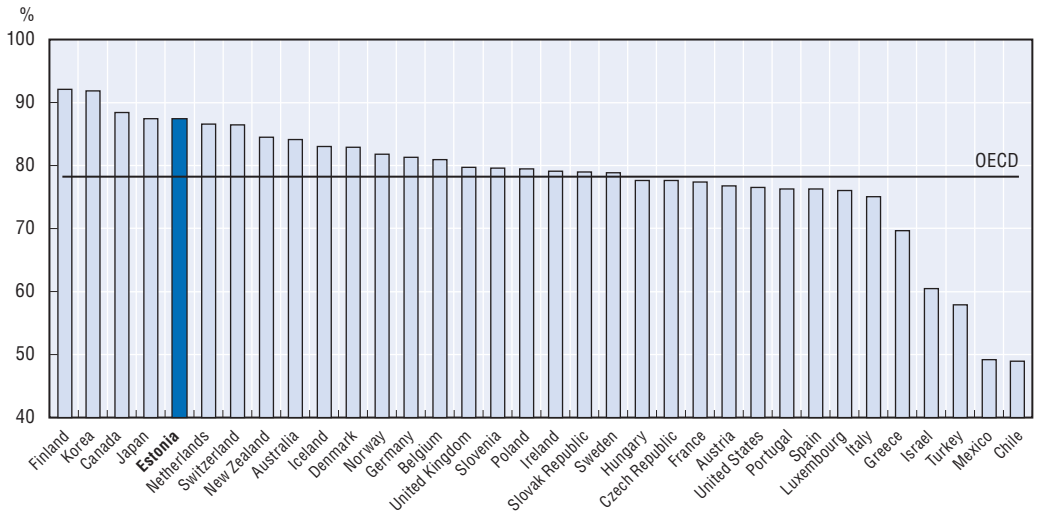
% of total general government expenditures



Data missing: Australia, Chile, Mexico and Turkey. Japan and Switzerland: 2007. Canada: 2006. New Zealand: 2005.
Source: OECD (2010), *National Account Statistics*, OECD, Paris.

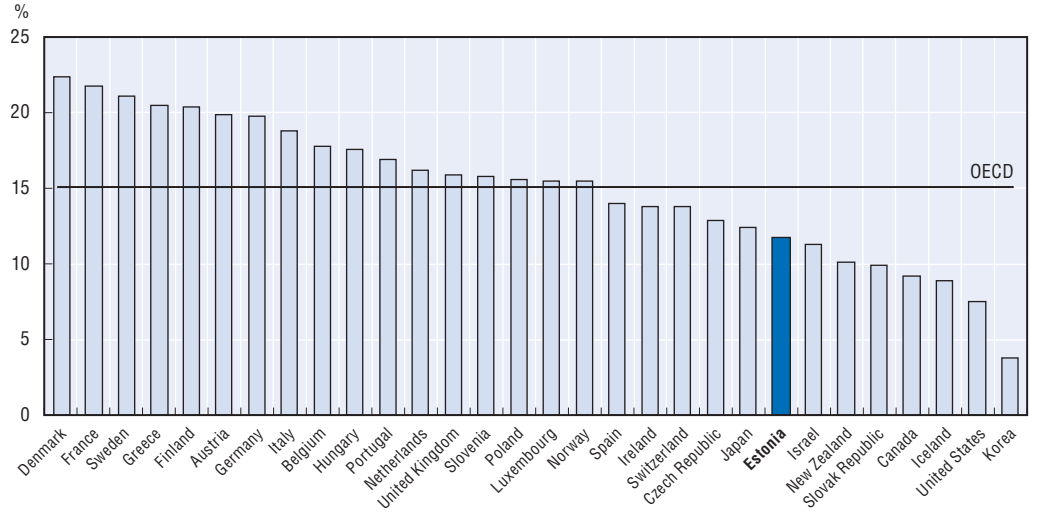
In terms of social protection expenditure, Estonia ranked 23rd among 30 OECD member countries in 2008 (see Figure 2.13). Total social protection expenditure represented 11.7% of GDP, 3.3 percentage points below the OECD average. Furthermore, if only European countries were to be considered, Estonia would rank 22nd out of 23 European OECD countries, just before the Slovak Republic. The lack of economic capacity, coupled with an emphasis on fiscal discipline, are among the reasons why it is difficult for Estonia to provide a similar level of social protection as most other OECD-EU member countries. Social policy choices reflect, in part, traditional expectations about the role of the state

Figure 2.12. **PISA 2009 – Average student performance on the mathematics scale**



Countries are ranked in descending order of the percentage of students at Levels 2, 3, 4, 5 and 6.
Source: OECD (2009), *PISA Database*.

Figure 2.13. **General government expenditures on social protection, 2008**
% of GDP



Data missing: Australia, Chile, Mexico and Turkey. Japan and Switzerland: 2007. Canada: 2006. New Zealand: 2005.
Source: OECD (2010), *National Account Statistics*, OECD, Paris.

versus the family and community for the care of the poor and the elderly. They also reflect current policy priorities, including competitiveness, cultural identity, national integrity, and the preparation of the future workforce.

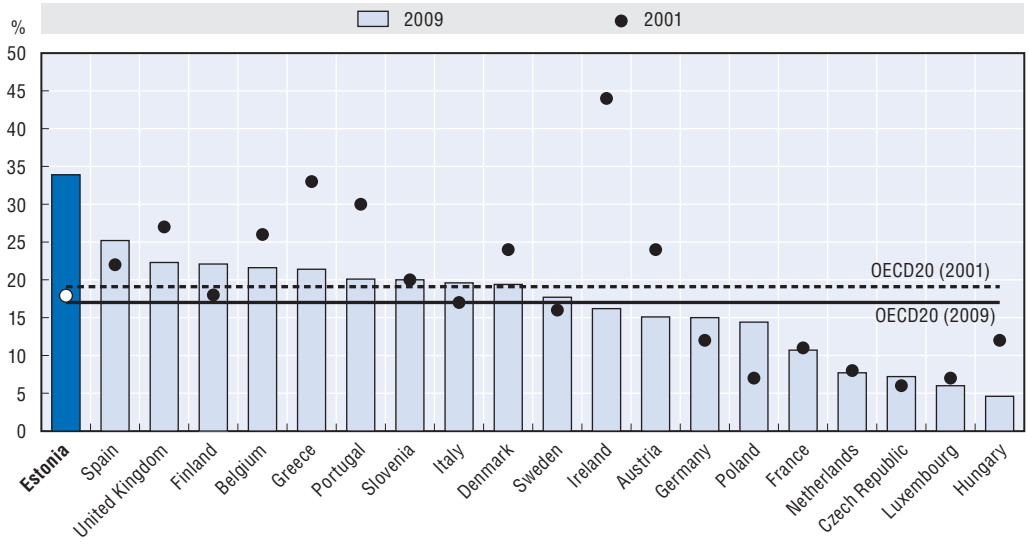
Old age poverty

The current low levels of social protection are generally insufficient to prevent certain social conditions from deteriorating. Poverty levels of old-aged citizens (over 65 years) in Estonia are a striking example. They increased considerably between 2001 and 2008, while old-age social benefits remained low compared to other OECD countries, even though

old-age social benefits represented the largest component of social protection expenditure. (For an extensive discussion on Estonia's social policies for elderly care, please see Case Study Two: Chapter 8: "Social Services for the Elderly in Estonia").

In 2001, 18% of citizens over 65 years of age were at risk of entering poverty, below the 19.1% average of 20 OECD-EU member countries. By 2009, a third of old-age citizens were threatened by poverty in Estonia, as the at-risk poverty rate for citizens over 65 had reached 33.9% (see Figure 2.14). However, during the same period, old age poverty decreased in the 20 OECD member countries by an average of two percentage points, reaching 17.0% in 2009.

Figure 2.14. **At-risk poverty rate of population aged 65 and over, 2001 and 2009**

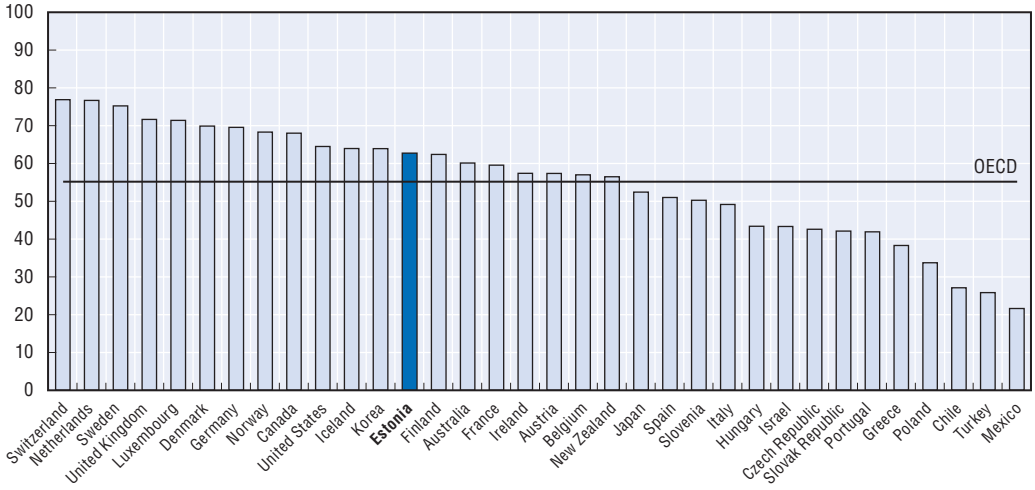


Source: Eurostat Databases (2010).

ICT and E-Government in Estonia

Estonia is particularly well regarded in ICT network readiness and successful e-government. Though the weight of the ICT sector in the economy is lower than in most OECD countries, Estonia ranks above the OECD average in the UN telecommunication infrastructure index (see Figure 2.15). In terms of the UN e-government development index, Estonia is on par with the OECD average. However, Estonia is a high performer amongst 24 OECD member countries in terms of both sophistication and full online availability of e-government services,[1] ranking 5th and 6th, respectively (see Figures 2.16 and 2.17). Furthermore, Estonia made considerable progress amongst 24 OECD member countries between 2007 and 2009 in terms of e-government user take-up[2] (see Figure 2.18). In 2007, Estonia's user take-up (30%) was four percentage points below the OECD average (34%), ranking 12th. Two years later, e-government user take-up in Estonia (44%) had made considerable progress by moving seven percentage points above the OECD average (37%), and by gaining four places in the rankings.

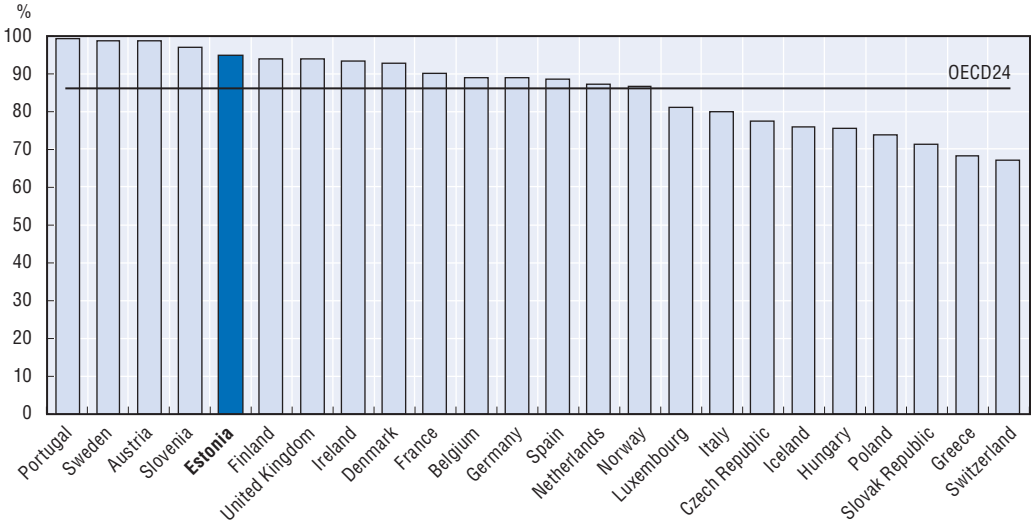
Figure 2.15. **Telecommunication infrastructure index, 2010**



Source: United Nations (2010), *E-Government Readiness Knowledge Base*, *www2.unpan.org/egovkb/index.aspx*.

Figure 2.16. **E-Government sophistication index, 2009**

24 OECD member countries



Source: European Union (2009), *Smarter, Faster, Better e-Government, 8th Benchmark Measurement*, prepared by Capgemini for the European Commission.

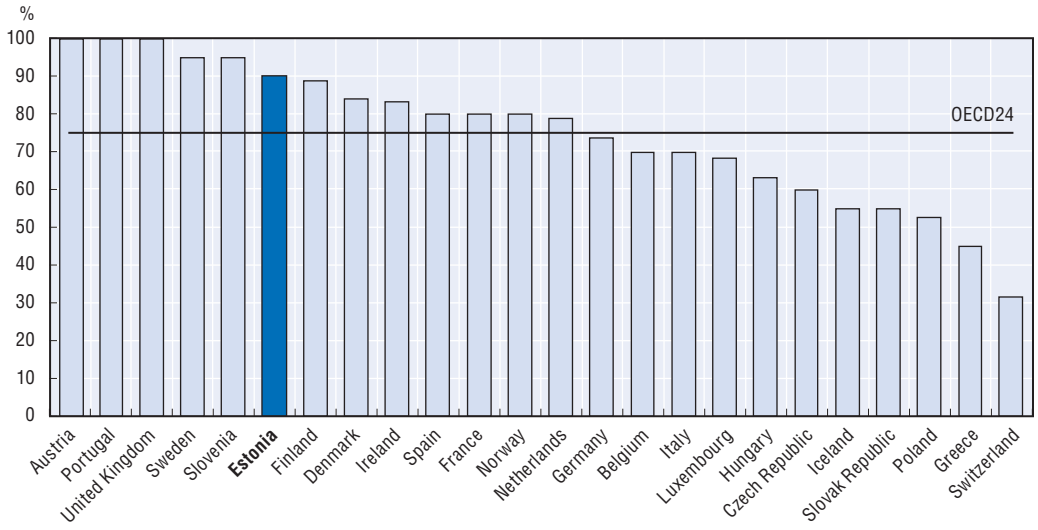
New challenges on the horizon

In addition to the current economic situation, Estonia faces an escalating financial burden and critical workforce capacity issues as a result of a decreasing and ageing population, and also due to the current high level of unemployment (16.1% in September 2010, compared to a 25 OECD-EU member country average of 9.3%).

Over the last 15 years, Estonia's overall population decreased by 7%, from 1.44 million in 1995 to 1.34 million in 2009. The population is expected to decline further, to approximately 1.2 million people by 2050. The main reasons for this decrease are negative net migration (which has evened somewhat in the last three years), and a low birth rate (which, while on the rise, remains low). Furthermore, in terms of the age structure of the

Figure 2.17. **E-Government full online availability index, 2009**

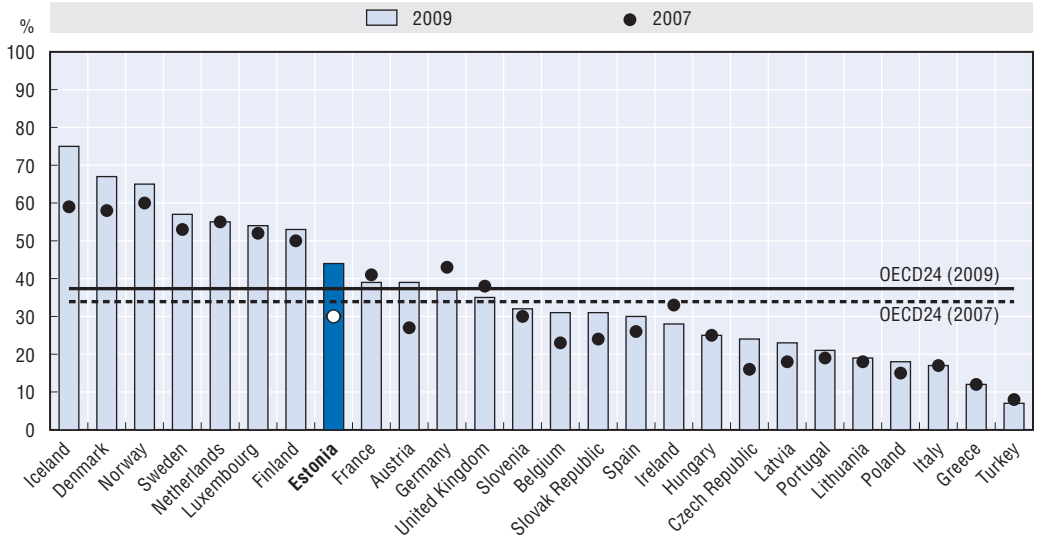
24 OECD member countries



Source: European Union (2009), *Smarter, Faster, Better e-Government, 8th Benchmark Measurement*, prepared by Capgemini for the European Commission.

Figure 2.18. **E-Government user take-up, 2007 and 2009**

24 OECD member countries, Latvia and Lithuania



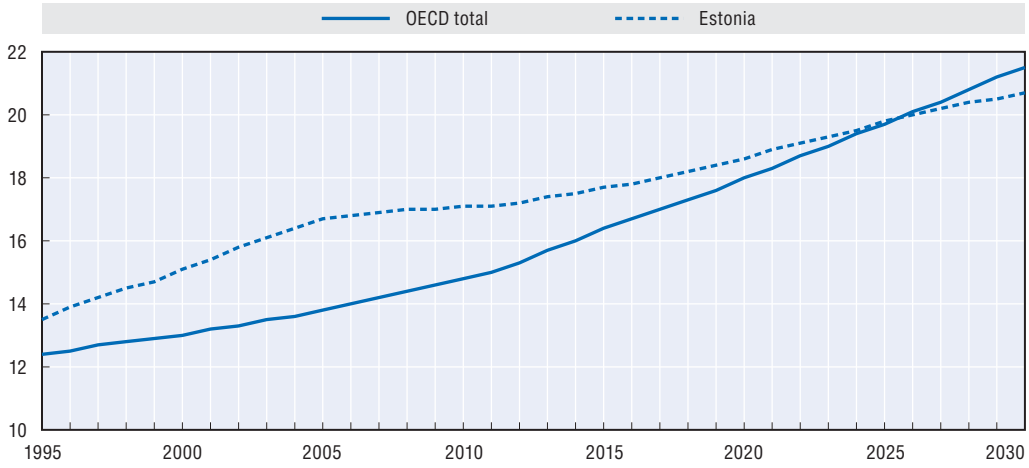
Source: *Eurostat Databases* (2010).

population, Estonia's dependency ratio[3] will increase faster than the OECD average over the next 15 years. Indeed, although the share of the working-age population[4] has increased by 3.2% since 1995, it is expected to have decreased by over 8.5% by 2025. (See Case Study Two: Chapter 8: "Social Services for the Elderly in Estonia".)

The Estonian population is getting older (see Figure 2.19). The share of the elderly population (17%) is currently higher than the OECD average, 14.6% in 2009. This percentage is expected to increase to reach 20% of the population by 2025, both for Estonia and the OECD average.

Figure 2.19. **Elderly population aged 65 and over**

% of total population



Source: OECD (2010), *Statistical Database*, OECD, Paris.

The growing dependency ratio and the ageing population put pressure on the provision of social benefits to citizens. As the population ages, taxable income goes down. This leads to a reduction in tax revenue for both the state and the relevant municipalities. Because the birth rate has remained low since the 1990s, the number of people entering the workforce – including those born just after re-independence – is also limited. Estonia therefore does not expect a strong or growing tax base in the near future, particularly given current unemployment levels.

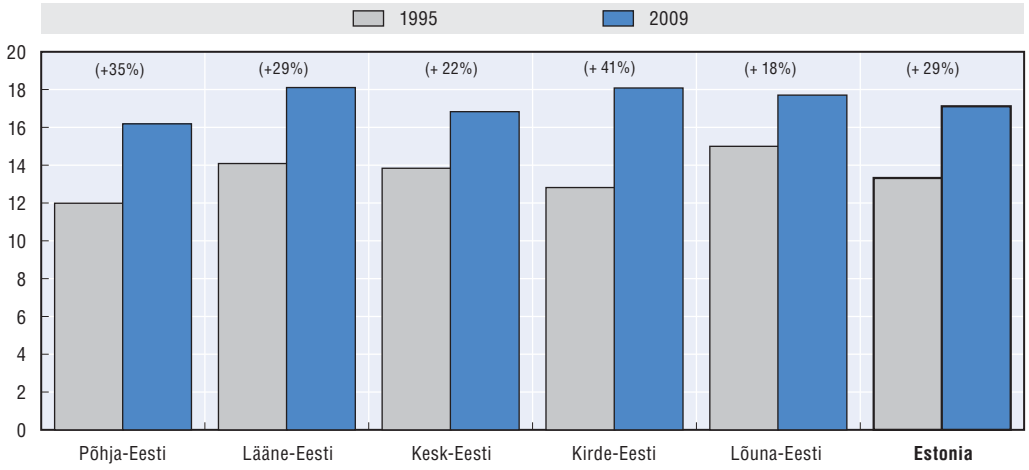
Regions in Estonia are ageing at a different pace, but they are becoming more similar in their share of elderly population (see Figure 2.20). Estonia's share of the population over 65 years old increased by 29% between 1995 and 2009. Though the Lõuna-Eesti (Southern Estonia) region held the highest elderly population in 1995, it was the region which saw its elderly population increase the least (28%) during the 1995-2009 period. On the other hand, the two regions – Põhja-Eesti (Northern Estonia) and Kirde-Eesti (Northeastern Estonia) – with the lowest share of elderly population in 1995 saw their shares increase the most.

Even as public service needs are growing, the global financial and economic crisis has forced the central government to cut municipal revenues and restrict their borrowing rights in order to keep the overall public sector on the desired path. It is estimated that the result of the recent cut in the income tax re-distribution rate (from 11.93% to 11.4% as a result of crisis-induced austerity measures) equated to revenue reduction of approximately EEK 300 million (EUR 19 million) for municipalities in 2009, which amounts to 2.2% of local government total revenues. The actual income of local authorities in the first eight months of 2009 dropped to 89% of the level for the same period in the previous year. This can be explained by an increase in unemployment rates from 6.5% in February 2009 to 11.2% at the end of August 2009. In addition, it is estimated that the increase in the VAT from 18% to 20%, together with other tax increases, will place an additional burden of EEK 200 million (EUR 12 million) on local budgets (Council of European Municipalities and Regions, 2009).

As in Ireland and Finland – other examples of small and open economies – market openness has been responsible for the economy's high level of competitiveness, but also for its vulnerability when the crisis hit. Prior to the global financial and economic crisis,

Figure 2.20. **Population over 65 by region, 1995-2009**

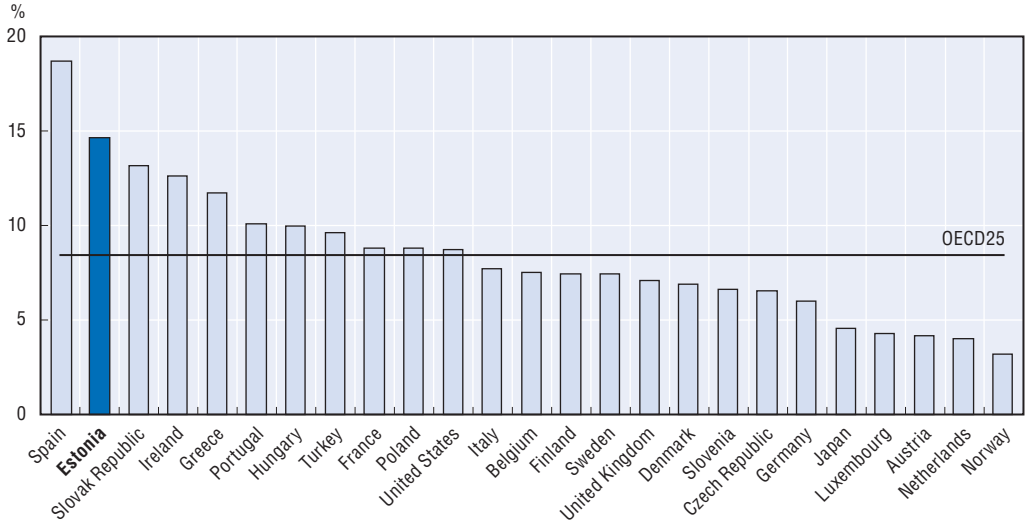
In % of total population, % change between 1995 and 2009 in parenthesis



Source: Statistics Estonia (2010), *Databases*.

unemployment in Estonia was relatively low. As of September 2010, however, Estonia had the second-highest level of unemployment among 25 OECD member countries (see Figure 2.21). Post-crisis, there are fears that the economy will face structural unemployment. Eighty per cent of individuals newly unemployed due to the global financial and economic crisis originated from the construction and manufacturing sectors, and significant labour market rigidities within those sectors will prevent mobility towards other growing sectors. If unemployment becomes structural, Estonia will experience even greater pressure on its social benefit capacity, particularly with respect to unemployment, professional training or re-training, and education.

Figure 2.21. **Unemployment rate, September 2010**



Source: *Eurostat Databases* (2010).

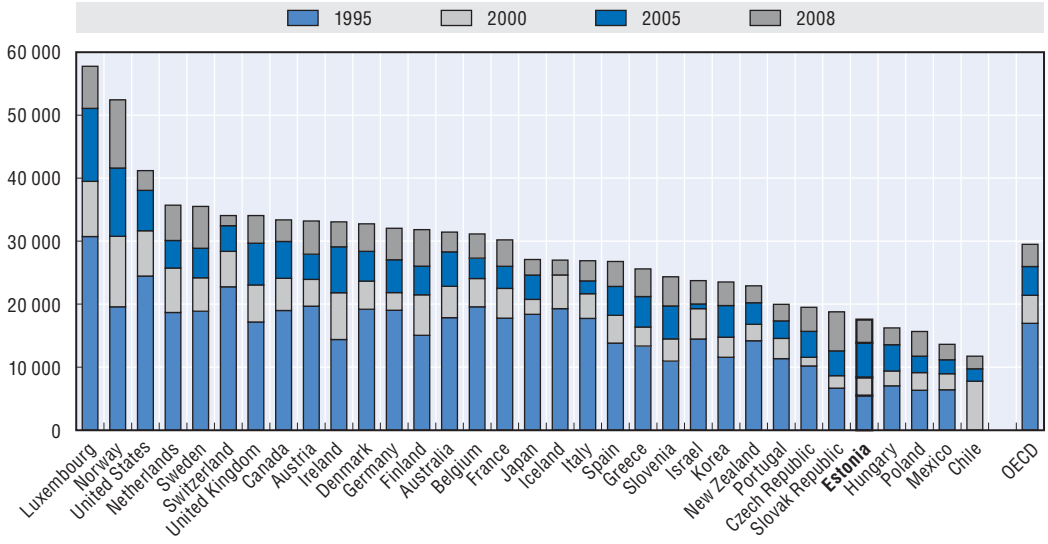
The high level of unemployment has not led to greater migration to strong urban centres: less than 1 400 people moved from rural municipalities to cities in 2009 (Statistics Estonia).This has an advantage of maintaining Estonia's working-age dispersion across the territory, one of its demographic strong points. If migration towards strong urban centres such Tallinn and Tartu does pick up, however, additional development and service delivery pressure will be put on these areas.

Well-being

Historically, disposable income per person in Estonia has been low compared to other OECD countries (see Figure 2.22), but it is on the rise. Income per person was approximately USD 17 500 in 2008. Although this level is about half of the OECD average of USD 30 000, it has increased considerably since 1995, when Estonia's level of disposable income per person was lower than that of all OECD countries. By 2000, it was slightly higher than Chile. Between 2000 and 2005, Estonia managed to overtake Mexico, Poland and Hungary in OECD rankings. In 2008, Estonia ranked just behind the Slovak Republic (USD 18 800) and the Czech Republic (USD 19 500). Rising incomes could, however, mean a gradual erosion of Estonia's cost competitiveness unless it is able to increase productivity and promote further economic innovation.

Figure 2.22. **Disposable income**

Per person



Source: OECD (2010), *Statistical Database*, OECD, Paris.

Public opinion, though subjective, provides a good measure of government performance. Estonians are more positive than most Europeans concerning the economic prospects of their country. In Spring 2010, four out of five Estonians believed that the economic and employment situation in their country would not worsen over the next twelve months, whereas only three out of five Europeans shared the same opinion (Eurobarometer, 2010a). Most probably due to recent membership, only one in five Estonians considers that the country has not benefited from EU membership, compared to almost two in five EU citizens in general. Though it is losing momentum, Estonians' trust

in EU institutions is still much stronger than for other EU citizens. A majority of Estonians – 58% – consider that the impact of the global financial and economic crisis on jobs has already reached its peak, whereas only two fifths – 42% – share the same view on average in the EU (Eurobarometer, 2010b).

The role of public management in economic growth and social well-being

Public management and governance reforms can generate macroeconomic benefits by stimulating the main drivers of economic growth, namely investments in physical and human capital. There are five mutually inter-dependent levers through which such reforms can influence economic growth:

- *Fiscal sustainability*: consolidating public finances to reduce deficits and debt.
- *Government efficiency*: increasing government productivity to reduce time and monetary costs for citizens and businesses interacting with government.
- *Regulatory machinery*: optimising market efficiency to provide a better business environment.
- *Strategic insight and strategic agility*: anticipating and adapting to new threats to reduce their negative impact.
- *Service delivery*: maintaining and developing social outcomes for government action to be more effective.

These levers do not necessarily have a direct influence on the levels of investment in physical and human capital. They do, however, provide the required incentives through which economic agents interact in order to decide whether or not to invest in human or physical capital. They also directly influence the overall structure of the system in which economic agents and social machineries function.

As in most OECD countries, the Estonian government will play a key role in restoring economic growth by boosting public sector productivity and maximising returns on investment in technology and human capital.

Economic Outlook

As of the third quarter of 2010, the Estonian economy was still adjusting itself following the severe recession it experienced due to the global financial and economic crisis. Mostly driven by exports, real GDP recorded positive growth in 2010. Manufacturing production has been re-vitalised, and although retail trade found momentum, the de-leveraging of households and unemployment will weigh on consumption for some time. This pattern will shape the recovery for 2011, while strong consumer spending will return in 2012. GDP growth is projected at 3.4% in 2011 and approximately 4% in 2012 (see Table 2.5).

The labour market began to show signs of improvements as employment started to grow in the second quarter of 2010 and the unemployment rate decreased following its record-high level of near 20%. Wages stopped decreasing and enterprises improved profitability. However, there is a high risk that structural unemployment will increase, as construction activity and employment opportunities remain constrained for some time. Inflation rose to 4% on an annual basis in September 2010. Extra caution will therefore be required during the first semester of 2011 to avoid unsolicited price increases following the introduction of the euro on 1 January 2011 (OECD, 2010c).

Table 2.5. **Economic Outlook for Estonia: Demand output and prices**

Percentage changes, volume (2000 prices)

	2008	2009	2010	2011	2012
Private consumption	–5.4	–18.4	–1.6	1.8	4.3
Government consumption	3.8	0.0	–1.7	1.3	1.5
Gross fixed capital formation	–15.0	–32.9	–12.7	6.1	11.2
Final domestic demand	–7.1	–19.0	–4.1	2.5	5.1
Stockbuilding[1]	–4.1	–3.4	3.8	0.0	–0.1
Total domestic demand	–10.5	–22.1	–0.1	2.5	4.9
Exports of goods and services	0.4	–18.7	16.2	10.0	8.1
Imports of goods and services	–7.0	–32.6	17.5	10.1	9.4
Net exports[1]	5.7	11.3	0.2	0.6	–0.5
GDP at market prices	–5.1	–13.9	2.4	3.4	4.1
GDP deflator	7.2	–0.1	–0.7	1.8	2.0
Memorandum items	*10.4*	*–0.1*	*3.0*	*3.4*	*2.5*
Index of consumer prices	8.7	–0.9	2.9	3.3	2.5
Private consumption deflator	–2.9	–1.8	–1.2	–1.9	–2.4
General government financial balance[2]	10.4	–0.1	3.0	3.4	2.5

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first.
2. As a percentage of GDP.

Source: OECD (2010), *Economic Outlook 88 Database*, OECD, Paris.

Notes

1. The sophistication indicator assesses the maturity of 20 basic e-government services. Each of the 20 basic e-government services is evaluated to know where the interaction between the service provider and user stands on a five-stage maturity model. The full online availability indicator measures the share of the 20 basic services that have reached the fourth stage on the same maturity model.
2. Percentage of individuals aged between 16 and 74 who used the Internet in the last three months to interact with public authorities.
3. Dependency ratio: Percentage of the population below 15 and above 64 years of age.
4. Working-age population: Population aged between 15 and 64 years of age.

Chapter 3

Public Governance Arrangements in Estonia

A country's public governance arrangements are a determining factor in the successful implementation of government programmes and reforms. Examining these arrangements both helps to frame the context in which the government and public administration operate and to identify the challenges faced by the public administration in implementing the government's agenda. Understanding the governance context also helps to determine how information flows can be enhanced among actors, both inside and outside the public sector, in order to improve co-ordination and collaboration, as well as co-delivery of services. In order to successfully implement reforms, the Estonian public administration must strike the right balance between the daily business of delivering policies, programmes and services, and carrying out its strategic function of anticipating needs, prioritising responses, and preparing and improving itself to meet those needs more efficiently and effectively, based on a full understanding of its strengths and weaknesses.

Introduction

As discussed in Chapter 2 of this report, the Estonian government is facing a number of considerable challenges which threaten fiscal sustainability: demographic changes due to a declining and ageing population; growing regional disparities; higher expectations for the quality and accessibility of public services provided to citizens and businesses; globalisation; and fiscal pressures compounded by the recent global financial and economic crisis. Because a country's public governance arrangements are a determining factor in the successful implementation of government programmes and reforms, examining these arrangements both frames the context in which the government and public administration operate and helps to identify the challenges faced by the administration in implementing the government's agenda.

Public governance can be defined as the formal and informal arrangements that determine how public decisions are made and how public actions are carried out from the perspective of maintaining a country's constitutional values as problems, actors, and times change. Public governance institutions and actors include levels of government, agencies, parliament, the judiciary, civil society and social partners (OECD, 2005c). Understanding the governance context allows the relationships among actors, both inside and outside the public sector, to be examined in order to determine how to enhance information flows, co-ordination and collaboration, and co-delivery of services. In order to successfully implement reforms, the Estonian public administration must strike the right balance between the daily business of delivering policies, programmes and services, and carrying out its strategic function of anticipating needs, prioritising responses, and preparing and improving itself to meet those needs more efficiently and effectively, based on a full understanding of its strengths and weaknesses.

This chapter provides further context through which to understand the findings and recommendations in the remaining chapters of this report. It describes Estonia's governance arrangements and identifies challenges faced by the public administration in implementing public sector reforms, by:

- describing Estonia's institutional framework;
- providing an overview of Estonia's public administration;
- identifying the challenges preventing successful public administration reforms.

Estonia's institutional framework

Political and administrative structures tend to develop based on historical cultural values. Public administration reforms that fit well with these cultural values have a better chance of taking root and being implemented successfully in order to meet their original objectives. Examining the historical construction of Estonia's political and administrative structure is crucial in order to understand the challenges faced by the public administration.

Origins and development

Due to the country's history, Estonia's governance arrangements emerged discontinuously and therefore did not develop in a way similar to most other OECD member countries. However, in comparison to some other Central and Eastern European (CEE) countries, Estonia had a foundation from which to build its institutions, government and civil service after regaining independence. A year after re-independence in 1991, Estonia implemented a new constitution, which set up government institutions similar to those in place during the first period of independence (1918-39). Nevertheless, the current institutional arrangements and administrative structures have also been influenced by the successive occupations of the Swedish Empire (16th-17th centuries), the Russian Empire (1721-1918), the Soviet Union (1939-41), Germany (1941-44) and the Soviet Union (1944-91). Since regaining independence, the Estonian public administration shaped itself by moving away from the inherited Soviet system and working towards European integration.

The EU accession process has been one of the most influential driving forces behind administrative reforms in Estonia. The underlying goal for Europeanising the public administration not only lies in guiding the country to become a member of the EU, but also in helping the country benefit from its membership. This provides a dynamic and constructive rationale to implement public administration reforms in the future.

The institutions of Estonian government

Estonia is a parliamentary democratic republic with a multi-party political system, and powers distributed between the executive, legislative and judicial branches of government. The state is unitary with a deconcentrated central government and a single-tier sub-national government. Legislation is based on the Constitution of 1992.

The Executive – The President and the government

According to the constitution, the President is the head of the state and supreme commander of the armed forces of Estonia. However, as Estonia is a parliamentary republic, the President's executive powers are limited and the President is mostly a symbolic figure with honorary functions. The President represents Estonia in international relations, may return a parliamentary act for revision, approve the dissolution of Parliament, and propose constitutional amendments. The President is elected via a secret ballot by a two-thirds majority of the *Riigikogu* (Parliament) for a maximum of two five-year terms. In order to ensure non-partisan leadership, the President's political party membership is suspended during his/her term of office.

The nation's supreme executive powers are vested in the Government of the Republic. According to the Constitution, the government's main responsibilities include: implementing the domestic and foreign policies of the state; proposing legislation to the *Riigikogu*; preparing and submitting the draft of the state budget to the *Riigikogu*; administering and implementing laws and resolutions of the *Riigikogu*; administering and implementing the state budget; and presenting a report on the state budget implementation to the *Riigikogu*.

According to the *Government of the Republic Act*, the government may contain up to 15 ministers including the Prime Minister. The government is headed by the Prime Minister and is comprised of 11 ministries, the Government Office and 15 county governments, as well as executive agencies and inspectorates, and their regional offices. Ministries are responsible for policy making, and their subordinate agencies are mostly responsible for policy implementation. There are currently 13 ministers in the 11 ministries and the Government Office (see Table 3.1).

Table 3.1. **Ministries and ministers in Estonia**

Number of public servants in ministries and their subordinate agencies in parenthesis

Ministry	Minister
Government Office (287)	Prime Minister
Ministry of Education and Research (190)	Minister of Education and Research
Ministry of Justice (3 130)	Minister of Justice
Ministry of Defence (3 970)	Minister of Defence
Ministry of the Environment (1 003)	Minister of the Environment
Ministry of Culture (112)	Minister of Culture
Ministry of Economic Affairs and Communications (972)	Minister of Economic Affairs and Communications
Ministry of Agriculture (1 060)	Minister of Agriculture
Ministry of Finance (2 421)	Minister of Finance
Ministry of Internal Affairs (7 455)	Minister of Internal Affairs
	Minister of Regional Affairs
Ministry of Social Affairs (1 188)	Minister of Social Affairs
Ministry of Foreign Affairs (511)	Minister of Foreign Affairs

Source: Estonian Government website; *www.valitsus.ee*; Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

The activity of the government is directed by the Prime Minister, who is the political head of state. In accordance with the Constitution, the Prime Minister supervises the work of the government, chairs government sessions, signs legislation adopted by the government, holds ministers to account, and proposes to the President any changes in the composition of the government. The Prime Minister is appointed by the *Riigikogu* on the recommendation of the President, and is usually the leader of the majority party of the coalition government. The Prime Minister's significance and role in the government and his relations with other ministries often depends upon the position of the party led by the prime minister *vis-à-vis* the coalition partners, and on how much influence the Prime Minister possesses within his/her own party.

The government is responsible to the *Riigikogu*, which has various tools and mechanisms at its disposal for influencing the executive – including the power to issue a vote of no-confidence on the government, the Prime Minister, or individual ministers. If the *Riigikogu* issues a vote of no-confidence on the Prime Minister, the entire Cabinet must resign. The Government may also dismiss the Parliament and call for new elections if the latter expresses a vote of no-confidence in the Government.

The Prime Minister nominates the ministers, who are formally appointed by the President and swear oath before the *Riigikogu*. Government members do not need to be members of the *Riigikogu* or have any political party affiliation, though they normally do. A government can resign for any of three reasons: the death or resignation of the Prime Minister; a vote of no-confidence in the government by the *Riigikogu*; the election of a new *Riigikogu*. However, Estonia's governments have tended to change frequently. Though national parliamentary elections have been held only on five occasions since regaining independence in 1991, Estonia has had 13 governments. Governments are usually coalition governments consisting of two to three different parties (out of a total of six parliamentary parties). The previous government – elected in 2007 – is the first one since 1991 to complete a four-year mandate.

The Government Office supports the government and the Prime Minister in policy drafting and implementation. The Government Office is headed by the Secretary of State, who has the status of a minister. The Secretary of State's responsibilities include monitoring

the legal conformity of draft legislation proposed by the government to the parliament, preparing the agenda and minutes of the Government sessions.

Offices within the Government Office include the Prime Minister's Office – which provides advice and support to the Prime Minister – as well as the Strategy Office, the Department of Government Sessions, the Department of Legislative Drafting, the European Union Secretariat, the Government Communication Office, and the Office of the National Security Co-ordinator. The Government Office has tended to transfer its non-core functions to ministries. For example, it has transferred responsibility for human resource management and civil service matters to the Ministry of Finance, and in 2011 the *National Official Journal* will move to the Ministry of Justice. A possible result of this may be a larger role for the Ministry of Finance, and greater sharing of the roles and functions of the Centre of Government, which is seen in other OECD countries, *e.g.* in Finland.

Members of the Government meet for regular sessions each week. The sessions are chaired by the Prime Minister, who approves the agenda prepared by the State Secretary. Members of the Government may propose items for the agenda. In addition to ministers, the Secretary of State, the Legal Chancellor, the Auditor General, and individuals invited by the Prime Minister may participate in Government sessions. Other individuals – such as county governors, representatives of the two national associations of local government, Secretaries General of ministries, officials of the Government Office, a representative of the President of the Republic and individuals invited at a minister's discretion – may observe a regular session of Government within certain parameters. Informal "cabinet meetings" of the Government are generally conducted to discuss issues prior to the official session of the government (see Chapter 5: "Building a Common Agenda").

Each ministry develops policy independently. When Estonia regained independence, there was a strong inclination to avoid the centralisation of power as experienced during the Soviet period. As in many other OECD countries, the Ministry of Finance is particularly strong and influential compared to other ministries. The Prime Minister's Office was set up to be equal among others; thus, it does not have greater or larger powers than the line ministries. It is, however, positioned to play a strong co-ordination role.

Legislature – The Riigikogu *(Parliament)*

Legislative powers are vested in the uni-cameral *Riigikogu* (Parliament). It is Estonia's supreme decision-making authority and its role is to represent citizens, businesses and civil society by contributing to policy making. It has 101 members who are directly elected every four years by proportional representation in 12 multi-mandate electoral districts. A national threshold of 5% of the votes is required for political parties to be represented in the *Riigikogu*. The last elections were held in March 2011 (see Table 3.2).

The main task of the *Riigikogu* is law-making. Draft Acts can be presented to the *Riigikogu* for consideration either by a member, faction or committee of the *Riigikogu* or by the government. Once the draft Act has been initiated, a leading committee is appointed by the Board of the *Riigikogu* to take a position and submit the draft Act to the plenary assembly of the *Riigikogu* for deliberation. Deliberations of draft Acts take place through three readings. After the third reading, a vote in the *Riigikogu* is cast, of which a majority of votes is required to pass the Act and for it to be presented to the President for proclamation. Once an Act is proclaimed, it is published in the *Riigi Teataja* (*State Gazette* also refered to as the *National Official Journal*).

Table 3.2. **Parliamentary election results, 6 March 2011**

	Number of votes	Percentage of votes	Number of seats in Parliament	Percentage of seats in Parliament	Change in number of seats since 2007 elections
RE – Estonian Reform Party	164 255	28.6	33	32.6	+2
K – Estonian Centre Party	134 124	23.3	26	25.7	–3
IRL – Union of Pro Patria and Res Publica	118 023	20.5	23	22.8	+4
SDE – Social Democratic Party	98 307	17.1	19	18.9	+9
Estonian Greens	21 824	3.8	0	0	–6
People's Union of Estonia	12 184	2.1	0	0	–6
Russian Party in Estonia	5 029	0.9	0	0	–
Estonian Christian Democrats	2 934	0.5	0	0	–
Independence Party	2 571	0.4	0	0	–
Independents	15 882	2.8	0	0	–
Total	**575 133**	**100**	**101**	**100**	**–**

Source: Estonia *Riigikogu* website *www.vvk.ee*. Results as of 8 March 2011.

Other responsibilities of the *Riigikogu* include authorising the Prime Minister to form a government, adopting the state budget and approving the report on the overall government spending including the report on budget implementation, electing the President, and appointing several public officials upon the recommendations of the President. They include the Prime Minister, the Chairman of the National Court, the Chairman of the Board of the Bank of Estonia, the Auditor General, the Legal Chancellor, and the Commander of the Defence forces.

Political parties

A large variety of political parties can be expected to develop in a country where proportional representation is used to elect the Parliament. Estonia is a perfect example. Many small interest groups and parties emerged in the wake of Soviet independence. Personal disagreements led to numerous parties being fragmented and merged to form new political parties. There were 32 registered political parties in 1997. Today there are significantly fewer political parties, mostly due to the 5% election result threshold to be represented in Parliament.

Culturally, political parties have tended to develop more around personalities than around ideologies. Parties tend to assemble people not only with the same ideologies but also from the same age group, and thus generation plays a significant role in the composition of Estonia's political parties. Many political party leaders have held previous government positions (for example, the current Minister of Economy and Communication was Prime Minister in 2003-05). Furthermore, there have been no clear left-wing governments over the last 15 years and the left-wing or centrist parties in government have not been the dominant coalition party.

The Judiciary

The independence of the Estonian judicial courts is guaranteed by the Constitution: no outside institution or organisation can intervene in their decision making. The judicial system, through its courts, has the exclusive competence to perform the function of administration of justice. The judicial system is administered by three levels of courts: first

instance – county and administrative courts; second instance – circuit courts of appeal; and third instance – the Supreme Court. The county courts hear all civil and criminal matters. Administrative courts handle litigations with the public administration. Circuit courts review judgements of county and administrative courts following appeals against judgments and rulings. The Supreme Court has the specificity of simultaneously performing the functions of the highest court of general jurisdiction, as well as of the Constitutional Court.

The first and second instance Courts are not entirely administered independently and separately from the executive power. They are financed from the state budget through the budget of the Ministry of Justice, and they are administered in co-operation between the Ministry of Justice and the Council for Administration of Courts. The Supreme Court, however, being an independent constitutional institution, administers itself and is financed directly by the state budget. A draft Courts Act proposing to reform the entire judicial administration in Estonia is currently being debated between the Ministry of Justice and the Estonian courts. This draft provides the first and second instance courts with stronger administrative independence from the executive (Ministry of Justice) by moving their administration to the same system as the Supreme Court (Ginter, 2010).

Estonia's public administration

Estonia's public sector as a whole employed 141 164 people in 2009 (Ministry of Finance, 2010a), almost evenly distributed between the government sector (72 410) and the local government sector (68 754) (see Table 3.3). Though these figures are not consistent with other statistical sources (such as Statistics Estonia) due to different data collection methodologies, the collection of public sector statistics is currently being re-organised (Ministry of Finance, 2010a). In 2009, 158 600 people were employed in the public sector according to Statistics Estonia, representing 23% of the total labour force. The relative size of the public sector decreased between 2000 and 2008, representing respectively 25% and 22% of the labour force. Most changes in the size of the total labour force were reflected in changes in the size of the private sector (see Figure 3.1).

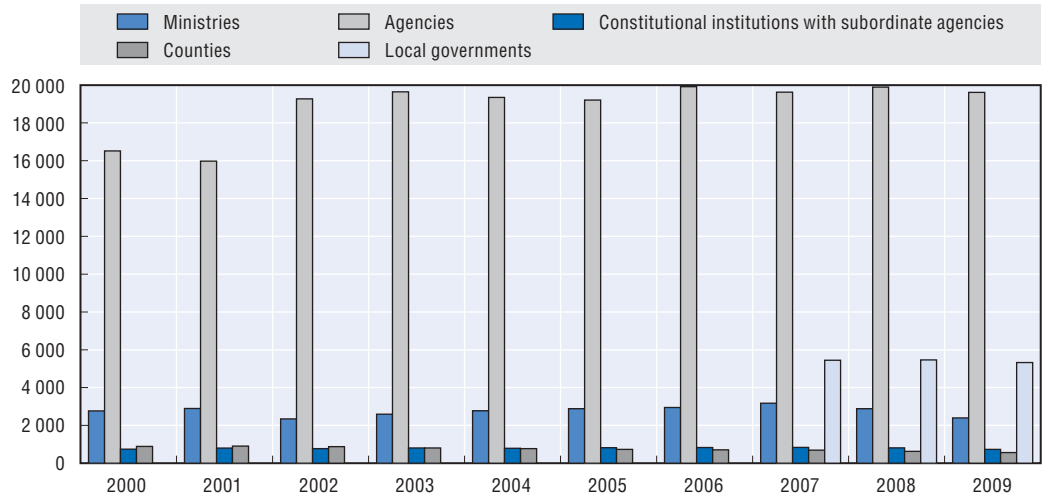
Table 3.3. **Employees in the public sector, 2009**

Public sector: 141 164 employees			
Government sector: 72 410 employees		Local government sector: 68 754	
State administrative agencies	26 597	Local government administrative agencies	37 078
State agencies administered by state administrative agencies	8 672	Local government agencies administered by local government administrative agencies	14 492
Legal persons governed by public law	10 257	Companies with local government participation	10 998
Foundations established by the state	9 547	Non-profit organisations	221
State-owned companies	16 947	Other foundations and for-profit organisations	5 964
Non-profit organisations	206		
Other foundations and for-profit organisations	184		

Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

The size of the public administration has been relatively stable over the past 10 years (see Figure 3.1). The largest increase in staff numbers occurred during 2002 due to the inclusion of professional military personnel in official statistics. Thus, the overall number of staff employed in the public administration between 2002 and 2009 has been rather constant at around 23 500 (without including local governments).

Figure 3.1. **Number of staff employed in the public administration, 2000-09**

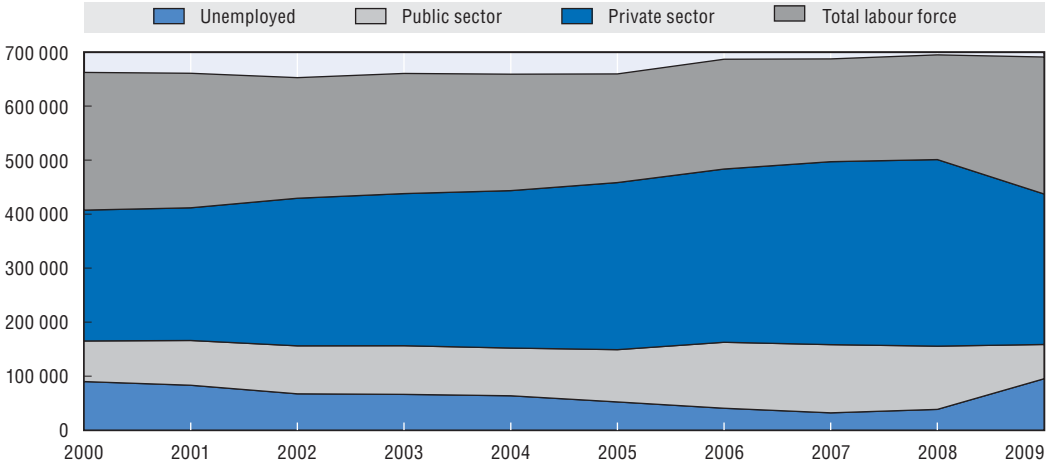


Note: The Government Office did not collect local government statistics before 2007.

Source: Ministry of Finance (2001), *Civil Service Annual Report,* Ministry of Finance of the Republic of Estonia, Tallinn; Ministry of Finance (2009), *Public Service in Figures 2008,* Ministry of Finance of the Republic of Estonia; Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn; Ministry of Finance, *Public Service Yearbooks 1999*, *2000, 2003, 2005, 2007*, Ministry of Finance of the Republic of Estonia, Tallinn.

The size of Estonia's public administration is within the range of comparison with some other OECD countries. With a general government employment rate of 18.7% of the labour force, Estonia's share of public employment lies between those of Luxembourg and Hungary (see Figures 3.2 and 3.3).

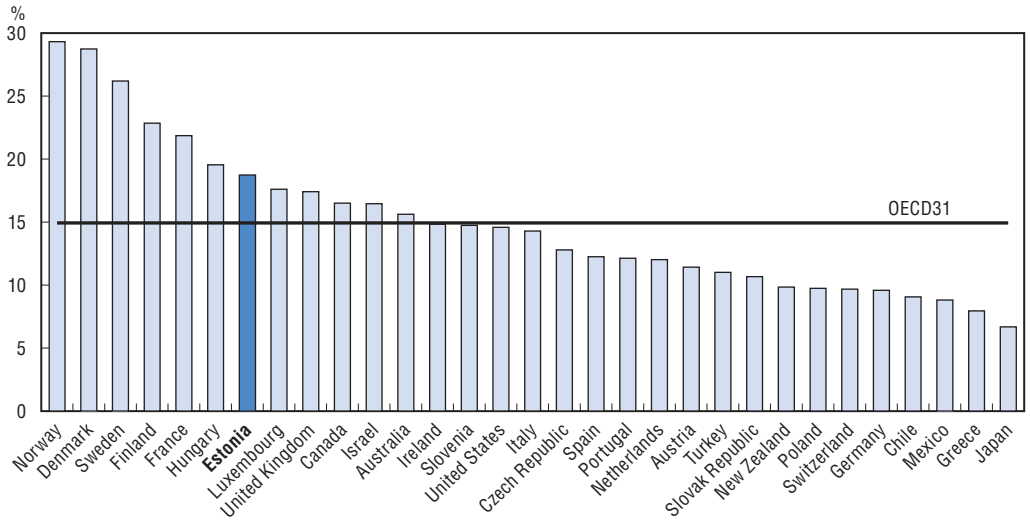
Figure 3.2. **Labour force structure: Employment in public and private sector and unemployment, 2000-09**



Source: Statistics Estonia (2010), *Databases.*

Figure 3.3. **Employment in general government, 2008**

As a percentage of the labour force



Notes: Data for Belgium, Iceland and Korea are missing. *Source:* International Labour Organization (ILO), *LabourSta Database*. Data for Turkey are from the Ministry of Finance and the Turkish Statistical Institute.
Japan: source of the employment data is Establishment and Enterprise Census. Employment is not classified according to SNA definition *i.e.* activity (market/non-market) and control by the government but status of employers as legal entities. The figure for employment in general government is substituted by direct employment by national or local governments instead of employment in general government.
Data for Australia, Chile and United States refer to the public sector (general government and public corporations).
Data for Austria, Czech Republic, Italy, Netherlands, New Zealand and Poland are expressed in full time equivalent employment. Finland, Israel, Mexico, Poland and Sweden: 2007 instead of 2008.
France, Japan, New Zealand and Portugal: 2006 instead of 2008.

Source: OECD (2011b, forthcoming), based on preliminary data from *Government at a Glance*, OECD, Paris.

State administration

The Estonian state administration is comprised of ministries and their subordinate agencies (boards and inspectorates), county governments, and constitutional institutions (for example, the Office of the President, the Legal Chancellor, the Bank of Estonia, the Government Office of the *Riigikogu*, the Supreme Court and the National Audit Office) (see Table 3.4). The subordinate agencies of ministries are quasi-autonomous, as they are under direct control of ministries and function under public law.

As of 31 December 2009, Estonia's public service employed 28 632 public officials,* representing 4.1% of the total labour force. Of these, 23 307 public officials were employed in state administrative bodies and 5 325 officials were employed in local government bodies (see Table 3.5). The size of the public service, in terms of numbers of officials, dropped by 3.5 % between 2008 and 2009, with the strongest reductions taking place in ministries (–16.9%) and in county governments (–11%).

As of 31 December 2009, there were 22 012 public officials employed in ministries and in their governing area (Ministry of Finance, 2010a). The 15 county governments employed 561 public servants. The Government Office and the five constitutional institutions employed 734 public servants. The Estonian state administration as a whole therefore employed 23 307 public servants in 2009, which was 3.8% less than in 2008. The size of

* An official is a person elected or appointed to an office of an administrative agency. State officials are distinguished from local officials.

Table 3.4. **Ministries, their subordinate agencies and foundations established by the ministries**

As of 31 December 2010

Ministry	Executive agencies under the Ministry	Non-executive agencies under the Ministry	Foundations under the Ministry
Ministry of Education and Research	• Language Inspectorate	• 66 Schools (mostly schools with special purpose and vocational schools and centres) • Estonian Maritime Academy • Estonian Aviation Academy • Estonian Language Institute • Tartu Observatory • 1 Museum • The National Examinations and Qualifications Centre • The Estonian Educational and Research Network • Estonian Biocentre • Estonian Youth Work Centre	• Information Technology Foundation • Estonian Science Foundation • "Tiger Leap" Foundation • "Ahhaa" Foundation Science Centre • Archimedes • Innove Foundation for Lifelong Learning • Sports Information Centre • Estonian Qualification Authority
Ministry of Justice	• The courts of first and second instance (including judges) • Prosecutor´s Office • Prisons • Data Protection Inspectorate	• Centre of Registers and Information Systems • Estonian Forensic Science Institute • Courts Centre of Accounting	
Ministry of Defence	• Estonian Defence Forces and Estonian Defence League • Defence Resources Agency	• 1 Museum • Seli Health Centre	• International Centre for Defence Studies • National Defence Development Foundation
Ministry of the Environment	• Environmental Board • Land Board • Environmental Inspectorate	• Põlula Fish Rearing Centre • 1 Institute • 1 Museum • Centre for Environmental Information	• Private Forest Centre
Ministry of Culture	• National Heritage Board	• 26 Museums • 4 Theatres • 3 Concert Organisations • 1 Institute • 1 Library • Conservation Centre Kanut • Folk Culture Development and Training Centre	• 5 Theatres or Foundations for Managing Theatres' Assets • Estonian Film Foundation • Song And Dance Celebrations Foundation • Foundation Estonian Journal of Culture • Foundation Narva Alexander's Cathedral • Foundation Tartu Jaani Cathedral • 2 Sports Centres • UNESCO Estoanian National Commission • Integration and Migration Foundation
Ministry of Economic Affairs and Communications	• Civil Aviation Administration • Road Administration • Maritime Administration • Competition Board • Patent Office • Consumer Protection Board • Technician Surveillance Authority	• Patent Information Centre • Informatics Centre	• Enterprise Estonia • Credit and Export Guarantee Fund KredEx • State Infocommunication Foundation • Estonian Accreditation Centre • Foundation Tallinn Science Park Technopol • Estonian Internet Foundation • Foundation Ida-Virumaa Industrial Areas Development
Ministry of Agriculture	• Agricultural Registers and Information Board • Veterinary and Food Board • Agricultural Board	• 3 Museums • 2 Institutes • Veterinary And Food Laboratory • Animal Recording Centre • Agricultural Research Centre • Rural Economy Research Centre	• Rural Development Foundation
Ministry of Finance	• Statistical Office • Tax and Customs Board		• Environmental Investment Centre

Table 3.4. **Ministries, their subordinate agencies and foundations established by the ministries** *(cont.)*
As of 31 December 2010

Ministry	Executive agencies under the Ministry	Non-executive agencies under the Ministry	Foundations under the Ministry
Ministry of Internal Affairs	• Public Service Academy • Police and Border Guard Board • Rescue Board • 15 County Governments	• 1 Museum • Ministry of Interior IT And Development Centre	• National Foundation of Civil Society • Foundation Tuuru
Ministry of Social Affairs	• Agency of Medicines • Social Insurance Board • Health Board • Labour Inspectorate	• Astangu Vocational Rehabilitation Centre • Illuka Reception Center for Asylum Seekers • National Institute for Health Development • Office of Conciliator of Collective Labour Disputes	• 3 Hospitals • 2 Rehabilitation Centres • Chamber of Disabled People • E-Health Foundation
Ministry of Foreign Affairs			• Estonian Foreign Policy Institute

Source: Information provided by the Government Office of the Republic of Estonia (2010).

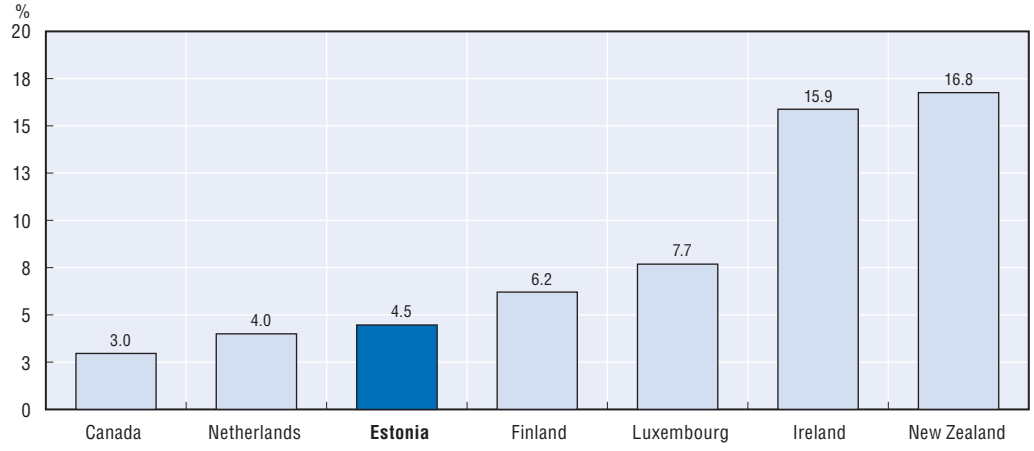
Table 3.5. **Size of the public service, 2007-09**

	2007	2008	% change 2007-08	2009	% change 2008-09
Total state administrative bodies	24 554	24 217	–1.4	23 307	–3.8
Ministries	3 129	2 882	–7.9	2 396	–16.9
Governing area of ministries	16 116	17 135	6.3	16 744	–2.3
Professional military	3 779	2 758	–27.0	2 872	4.1
Constitutional institutions	837	812	–3.0	734	–9.6
County governments	693	630	–9.1	561	–11.0
Local government bodies	5 449	5 464	0.3	5 325	–2.5
Total public service	**30 003**	**29 681**	**–1.1**	**28 632**	**–3.5**

Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

Estonia's public service is 4.5% of general employment, compared to Canada (3%), the Netherlands (4%), Finland (6.2%), Luxembourg (8%), Ireland (15.9%) and New Zealand (16.8%) (see Figure 3.4).

Figure 3.4. **Share of employment in central government within total employment, 2008**



Source: International Labour Organisation (2010), *Statistics Database*.

Sub-national administration

The Ministry of the Interior's Department of Regional and Local Affairs (Ministry of Interior/Regional and Local Affairs) is responsible for general policy planning and the development of the sub-national level (counties and municipalities) in Estonia. The Ministry of Finance is responsible for local government finance and budget issues. The external control of the municipalities is the responsibility of the County Governors, the Legal Chancellor and the National Audit Office.

Regional administration

Territorially, Estonia is divided into 15 counties, led by a County Governor. These are direct representatives of the central government at the regional and local levels. They monitor municipal services, give advice to municipalities and are in charge of county-level planning. The county government is a non-elected body consisting of civil servants serving the Office of the County Governor. The County Governor is appointed by the Government for five years on the proposal of the Minister of Regional and Local Affairs, and reports to the Minister of Regional and Local Affairs. County municipalities have input into the process through the general meeting of the national municipal associations which provide their opinion on the candidate. The Governor represents the interests of the state in the county and is responsible for the county's comprehensive and balanced development, including supervising the correct enforcement of national regulations at the local level. The legal status of county governments is relatively weak because almost every final decision is taken either at the central or municipal level. The county government can appeal to court if a municipality does not comply with the law. A county government also has the right to control the performance of state functions assigned to local governments.

Government and state agencies (including executive and non-executive) may have regional offices (subordinate state agencies). For example, the central agency Social Insurance Board has two regional divisions (North and South) covering the whole country. Within the structure of these two divisions, customer service units provide direct services to citizens. There is no centralised system for creating regional offices of state agencies, and each ministry has organised its structure according to its own needs. Therefore, state agencies that have offices at the local level do not necessarily distribute their offices across the country in the same way – some agencies have offices in all counties, while others do not.

The sub-national statistical data collected by the EU and the OECD do not distinguish the 15 Estonian counties as separate entities. For cross-country comparison purposes, they are aggregated as five regions at the NUTS 3/TL3 level (Põhja-Eesti/Northern Estonia; Lääne-Eesti/Western Estonia; Kesk-Eesti/Central Estonia; Kirde-Eesti/Northeastern Estonia; Lõuna-Eesti/Southern Estonia). Estonia is considered as one whole entity at the NUTS 2/TL2 level. As most of Estonia's regional development policies are targeted at the county level, it is therefore difficult to analyse the effect of these policies in comparison to other regions in OECD and EU countries.

Local administration: Municipalities

Estonia has a long tradition of strong local government. Before independence in 1918, there was a system of local administration consisting of 11 regions and approximately 400 local administrations. In the 1930s, reforms to improve local government were introduced, only to be cut short. Under the centralised Soviet system, the regional level was

strengthened while the village councils remained weak. In the 1980s, a movement towards local self administration began, and in 1989 the Supreme Council of the then Estonian Soviet Socialist Republic adopted the *Act on the Principles of Local Government*, setting up primary-level local authorities in every town and rural district. In 1993, the *Local Government Organisation Act* established the ruling functions, jurisdictions, responsibilities and organisational structure of local authorities, and their relationship with other local bodies and with the national government. In addition, this Act established the institutional structure of local authorities, wherein each municipality must have a municipal council, a municipal government, an auditing committee and a mayor. In 2010, there were 226 municipalities in Estonia (33 cities and 193 rural municipalities).

Most of Estonia's municipalities are small in terms of population, with a median size of 1 745 residents. There is also a high population concentration in the two largest cities. Over one-third of the population resides in the capital city of Tallinn (407 000) and the main university city of Tartu (98 000).

A Municipal Council is elected by the municipality's residents in a secret ballot for a four-year term. The number of councillors depends on the population of the municipality, with a minimum of seven members. The Council elects the chairman (head) of the Council. The chairman organises the Council's work, represents the Council and fulfils other duties imposed by law or municipal statute. Councils can and set up committees that handle permanent functions. The chairs of all such committees and all members of the audit committee are elected by the Municipal Council from among its members. The members of the municipal government are confirmed to office on the proposal of the municipal mayor (approved by the Council). The government may include municipal employees or political appointees. Members of the Council cannot be members of the municipal government. The municipal mayor is the head of the municipal administration and the municipal staff is employed by the mayor. The mayor is elected by the Municipal Council either from among its members or an external candidate, and acts primarily as a municipal manager. The main civil servant is the secretary of the municipal office. The Municipal Secretary prepares the materials for the sessions of the government and the Council.

The central government can, and has significantly, delegated supplementary functions to the local government. The Constitution states that the government must cover the costs of implementing any function delegated by law (UNPAN, 2004). In the event they are unable to carry out their responsibilities, local governments cannot delegate their functions to the county level.

Estonian municipalities are in charge of a wide variety of tasks. The most important municipal task in terms of expenditure is education (primary and secondary schooling). This is followed (also in terms of expenditure) by culture and leisure, social services, housing services and environment protection. Other municipal tasks include utilities, administration and public order and safety. All municipalities, irrespective of size or type, are expected to provide the same basic services. Since 2001, the municipalities have no legal responsibility to fund or organise health care.

Municipalities have the right to form voluntary associations at the county (regional) and state levels to perform non-mandatory tasks on behalf of local authorities. These can take the legal form of NGOs, municipal enterprises, etc. A municipality or city may create smaller districts in order to provide municipal services. The procedure for forming districts is regulated by the *Local Government Organisation Act*.

As there is no second-tier sub-national government in Estonia, co-operation among municipalities within a county is of significant importance. In every county there is a County Municipal Union whose membership is voluntary for the municipalities. The County Municipal Union is consulted on the appointment of a county governor.

In addition to the County Municipal Unions, there are two national municipal associations: the Association of Estonian Cities and the Association of Rural Municipalities of Estonia. These associations represent the member municipalities in negotiations with the central government. Not all local governments necessarily belong to either of these associations.

Identifying challenges to successful public administration reform

All states are confronted with how to design and implement reform in the most effective and sustainable manner possible. The challenge of reform sustainability has become a key topic for many OECD countries, and research is suggesting that often, whether or not policy "sticks" may be in part a function of the policy sector in question. Thus, the approach to ensuring successful and sustainable education reform may differ from reforming trade regimes, for example (OECD, 2010b). When considering reform, countries can usefully consider not only what they want to accomplish and how, but which sector is being affected as well. They should also consider the framework in which reform can be achieved, ranging from the administrative context to the resources available. In the Estonian case, consideration of size is important, as well as the unique traits associated with public administration reform in Estonia.

Characterising small-state public administrations

Estonia's ability to implement sustainable reform in the public administration faces a structural challenge: its size. It is a small country and a small state. The public administration in Estonia exhibits a set of five inter-related characteristics that are common to some degree across small states (Sarapuu, 2010):

1. **Limited scope of goals and activities.** Small state administrations have to fulfil certain public prerogatives, such as maintaining health and education systems, independent of the size of the country. Small states therefore need to prioritise and limit the number of goals and activities they pursue, the scope of action, and the means of delivery (*e.g.,* production *versus* purchase of certain public goods).
2. **Multifunctionalism of civil servants and organisations.** Public officials in small administrations tend to have many and diverse responsibilities compared to their peers in larger administrations, who have more opportunities to specialise in a particular field. This is also seen in state bodies; for reasons of scale and resource sharing, there is a greater tendency to merge units (*e.g.,* ministries, agencies, etc.) than to establish or maintain separate entities.
3. **Informality of structures and procedures.** Formal co-ordination mechanisms are more limited in small states, and there is a tendency for structures to adapt to individuals rather than individuals to fit in formal organisational frameworks. While personal relationships are important in any system, senior civil servants in small states are more likely to use informal means of communication to consult and inform one another. Civil servants depend on these relationships – which can combine the professional and

personal – in order to properly execute their responsibilities. These relationships can also serve as a bridge between executives and lower levels of organisations.

4. **Constraints on steering and control.** Independent scrutiny and reporting mechanisms tend to be less frequent in small states than in large ones due to limited resources, lack of specialisation and political partisanship. The political-administrative interface is usually less clearly defined in small states, with greater mobility between the administrative and political spheres. Senior civil servants therefore can have more autonomy in smaller states due to less formal oversight.
5. "**Personalism**" **of roles and functions.** The multifunctionalism, informality, and limited control in small states allow a limited number of individuals to exercise quite a bit of influence based on their competencies, networks, and personal qualities. While this can support agility and problem solving, it also leaves room for *ad hoc* decision making and subjective judgement.

Each of these characteristics is manifest differently in individual countries. Small states lie on a continuum in terms of size, but country characteristics are also dependant on the national context and governmental policy choices. It is therefore difficult to predict specific outcomes for Estonia. It is useful, however, to keep these characteristics of small states in mind in determining the governance and management choices ahead of Estonia as it seeks to realise its needs and ambitions, and the context in which reforms will be implemented. These characteristics are not "good" or "bad" in and of themselves, but their interaction influences countries' governance contexts. For example, aspects of "personalism" that might be perceived as "leadership" in a system with institutional checks and balances can take on a less benevolent aspect in an absence of counter-balancing forces.

As both a small country and a small state, Estonia faces resource constraints not experienced by larger ones. Small states, however, also enjoy many advantages, including extensive networks which they can successfully use to realise their objectives, and comfort with multifunctionalism. By developing a single government approach, Estonia is seeking to continue building on the advantages it has as a small state while also remaining vigilant with respect to some of the difficulties posed by size.

The unique traits of public administration reform

Public administration reform carries its own set of challenges including: a lack of social demand for administrative reform; public resistance to forms of change; a requirement to "reform the reformer"; and managing the inter-dependencies between political and administrative institutions and actors (OECD, 2010b). Efficient, effective, accountable and transparent public administration can boost legitimacy, trust and commitment to the economic and political reform agendas, as well as improve the quality of policy design and implementation. However, public sector reforms are often complex, unpopular, contested and risky. They require time to produce results and prove their benefit.

The combination of prioritising economic objectives on the one hand, and the ability of a limited number of individuals to exercise quite a bit of influence – "personalism" – on the other, may have created circumstances in which public administration needs are unrecognised and under-valued in terms of providing immediate political payoff. These factors may also be exacerbated by multifunctionalism, which leads to low levels of both capacity and capability to undertake reforms. OECD experience offers a broad set of

recommendations to facilitate sustainable public sector reform, and boost the sustainability of the public administration (OECD, 2010j):

- *Set priorities*. Reforms often have many dimensions, with differing degrees of priority. Public administration reform should not be a priority in and of itself, but it does link to achieving government objectives ("the business case for reform"). A clear understanding of these linkages seems to be absent in Estonia, which may be contributing to the slow pace of public administration reform.
- *Create a clear roadmap*. It is important for the government to develop a clear roadmap with a path of change (sequencing) and a calendar for reforms. Uncertain situations are detrimental to stakeholder relations and send mixed signals to citizens, for whom the reform path is often completely unclear. The present public administration reform agenda in Estonia seems to be weighed down by legislative uncertainty and lack of clear guidance.
- *Clearly identify the "winners" and "losers" of a reform.*"Losers" should be acknowledged, and their losses taken into account. This could be in the form of a financial incentive or greater autonomy in certain policy fields. It can also involve improving the communication of overall benefits (for society, etc.) that are real, but diffuse. Such an approach requires both dialogue with stakeholders and clear analysis to identify likely outcomes, as well as costs and benefits. Both social participation and evidence-based decision making need to be further developed in Estonia.
- *Follow up implementation*. Capacity for reform implies both the capacity to launch reform and to follow up its implementation and provide regular assessments. This requires evaluation, performance measurement, and feedback mechanisms; these are currently lacking or under-developed in Estonia.
- *Maintain flexibility in implementation*. Often, the object of reform is an evolving process, as in the case of decentralisation: it is not a policy outcome itself, but a governance tool to improve outcomes such as service delivery. Thus, the system has to remain flexible to permit evolution and adjustment as appropriate. Given its history of changing coalition governments, however, Estonia tends to embed its reform initiatives in legislation as a means to "make them stick".
- *Focus communication on the outcomes of the reform*. Citizens are generally not very interested in public administration reform – unless of course it touches such services as health, education, social assistance, etc. Support for reforms has to be gained through clear indications and evidence of improvement, for example in service delivery or economic competitiveness. Communication should focus on positive lessons.
- *Exploit windows of opportunity.* The global financial and economic crisis is one example. While it revealed weaknesses in governance systems, it provides an opportunity to try new methods of operation and to accelerate change. Estonia has made good use of this opportunity for economic and labour market reforms. Capitalising on it now to reform its public administration would be further evidence of strategic agility.
- *Leadership*. Virtually all assessments of public administration reform confirm the importance of strong leadership. Many also point to the need for government cohesion in support of the reform: if the government is not united around a reform proposal, it will send mixed messages and opponents will exploit its divisions; this usually results in defeat. Cohesion appears to matter more than factors such as the strength or unity of opposition parties, or the government's parliamentary strength. In the Estonian context,

personal leadership, as typified by "personalism", needs to be tempered and channelled in support of collective objectives and priorities.

All of these factors need to be taken into account as Estonia develops a single government approach that is not based on an ideal model of reform or a "cookie-cutter" adoption of international experience, but that takes into account the specificities of its history, culture, economy and people. Moving towards a single government approach requires political- and administrative-level commitment to policy outcomes, and mutual agreement among these levels to act in unison. Not only is this essential to realise individual policy initiatives – sectoral and across sectors – it is also fundamental for establishing a vision for Estonian society, and how Estonia wishes to define itself in the European and broader international communities. The subsequent chapters of this report lay out both the major challenges faced by Estonia, as well as the changes that need to be put in place in order to put it on a path towards a single government approach:

- Promoting a Whole-of-Government Approach (Chapter 4): illustrates how the concept of a single government approach has been used in other OECD countries; examines what it could mean in an Estonian context; and presents the formal and informal levers that need to be addressed in order to support the public administration to work in such a way.
- Building a Common Agenda (Chapter 5): presents strategies and practices for developing and building consensus around a long-term vision for Estonia; and for strengthening the public administration to better support government priorities. It looks at how to better achieve social outcomes through evidence-based decision making and performance management, and it examines possible routes for broadening decision-making inputs in order to improve the quality of and consensus around government decisions.
- Delivering Public Services Effectively (Chapter 6): addresses the many actors across levels of government that need to work together in new ways in order to efficiently deliver citizen-focused services. In doing so, it examines issues of their capacity and capability, the ways in which they can better co-operate, and the vision and support that is needed to enable new ways of working.

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Chapter 4

Promoting a Whole-of-Government Approach

Estonia's governance structure combines strong vertical silos and formal, legalistic arrangements with many personal and informal networks. Moving to a single government approach is a long-term process founded on political commitment and leadership that transcends party lines and individual electoral terms. In Estonia, both the formal and informal will need to be addressed in order to promote informal co-ordination and co-operation, while some processes and networks will need to become more institutionalised in order to improve sustainability of working methods and information management. In addition, mechanisms to strengthen co-ordination and co-operation in both the political and administrative spheres are needed. A whole-of-government approach also applies to the management of the public administration itself where greater flexibility of staff and structures and improved co-ordination can help promote staff mobility and a whole-of-government understanding of tasks and roles.

Introduction

Faced with fast-changing economic and societal pressures, governments need to proactively respond to complex policy issues. The global economic and financial crisis, climate change, an ageing population, and health and natural-disaster emergencies are just some examples of circumstances requiring policy responses that do not fit neatly into any one organisation's competencies. In addition, citizens and businesses have increasing expectations for public services that are effective, high quality, accessible, and varied. Achieving these outcomes requires joint action where public administrations work in a co-ordinated and collaborative manner across organisational boundaries. This is one reason why OECD countries are increasingly interested in utilising whole-of-government approaches in policy development and implementation.

Working in a more whole-of-government manner helps to increase the efficiency and effectiveness of the public administration in implementing the government's programme, and to promote citizen- and business-oriented public service delivery. Its features include horizontal co-ordination in policy design and execution as a means for helping public administrations to better respond to government needs by focusing on desired outcomes, encouraging and supporting collaboration, and ensuring informed decision making (see Box 4.1).

Box 4.1. **What is "whole-of-government"?**

"Joined-up government" or "whole-of-government"* approaches are associated with a desire to ensure the horizontal and vertical co-ordination of government activity in order to improve policy coherence, better use resources, promote and capitalise on synergies and innovation that arise from a multi-stakeholder perspective, and provide seamless service delivery to citizens and businesses. It requires government bodies, regardless of type or level, to work across portfolio boundaries to achieve shared goals and to provide integrated government responses to policy issues. Such an approach applies to both formal and informal working methods, and to the development, implementation, and management of policies, programmes and service delivery. A capacity to genuinely collaborate fundamentally enables a public administration to be more responsive to the needs of government and citizens.

Improved co-ordination and integration – the foundation on which "whole-of-government" rests – is not new to the public administration. It is, however, gaining attention as governments react to the silos and fragmentation that, in some cases, have been exacerbated by New Public Management (NPM) reforms, as well as to asymmetries arising from structural devolution at the central level, greater complexity in policy challenges, and a need for efficiency gains.

The term "whole-of-government" is broad, and applies to both central and sub-national (regional and local) levels and policy sectors. It also includes the relationship between government and external actors. Assessing whether or not a "whole-of-government" approach is in place depends on numerous factors. Three inter-related ways to estimate "joined-up-ness"

Box 4.1. **What is "whole-of-government"?** *(cont.)*

include: 1) measuring the degree to which elements of good practice are being followed; 2) engaging in stake-holder dialogue, *i.e.*, do stakeholders notice a difference?; and 3) evaluating outcomes which may be best suited to addressing the impact of a "whole-of-government" approach, as opposed to the processes behind it (Pollitt, 2003).

Academics studying whole-of-government approaches identify at least three primary lessons: first, one size does not fit all. In other words, horizontal approaches may not be appropriate for the entire public sector in all situations. Second, there is often a "bottom-up" element to initiating and promoting single government approaches, and thus room needs to be made for this possibility since it can strengthen "joined-up-ness". Finally, embedding a whole-of-government working culture is a long-term endeavour. It requires time to develop, implement and take root, and thus it must be "owned" by the full government and public administration rather than be seen as the initiative of any single political party. "The role of a successful reform agent is to operate more as a gardener than as an engineer or an architect" (March and Olsen, 1983, in Christensen and Laegreid, 2007).

* Joined-up government and then whole-of-government have evolved in such a way to often be used synonymously, as they will be in this report, along with single government. The description provided is based on Christopher Pollitt's 2003 definition of joined-up government: Joined-up government is a phrase which denotes the aspiration to achieve horizontally and vertically co-ordinated thinking and action. Through this co-ordination it is hoped that a number of benefits can be achieved. *First*, situations in which different policies undermine each other can be eliminated. *Second*, better use can be made of scarce resources. *Third*, synergies may be created through the bringing together of different key stakeholders in a particular policy field or network. *Fourth*, it becomes possible to offer citizens seamless rather than fragmented access to a set of related services (Pollitt, 2003).

Sources: Adapted from Christensen, T. and P. Laegreid (2006), "The Whole-of-Government Approach: Regulation, performance, and public sector reform", *Working Paper 6*, Stein Rokkan Centre for Social Studies, UNIFOB AS; Christensen, T. and P. Laegreid (2007), "The Whole-of-Government Approach to Public Sector Reform," *Public Administration Review*, November/December 2007; Management Advisory Committee (2004), *Connecting Government: Whole-of-Government Responses to Australia's Priority Challenges*, Commonwealth of Australia, Canberra; Pollitt, C. (2003), "Joined-Up Government: A Survey", *Political Studies Review*, 2003, Vol. 1.

Governments pursuing a single government approach are confronted with challenging questions such as how to lead and resource horizontal approaches, and how to communicate on the impact of public action to sectoral and cross-cutting constituencies. In the case of Estonia, pressing challenges include: defining the strategic role of the Centre of Government; promoting institutional co-ordination structurally; ensuring sufficient resources for co-ordination; and building ownership for implementation. This chapter lays out some of the elements necessary for putting in place a whole-of-government approach. It identifies where Estonia lies on the spectrum of joined-up practices, and then examines the structural and cultural changes to the public administration that are needed in Estonia to support a single government approach.

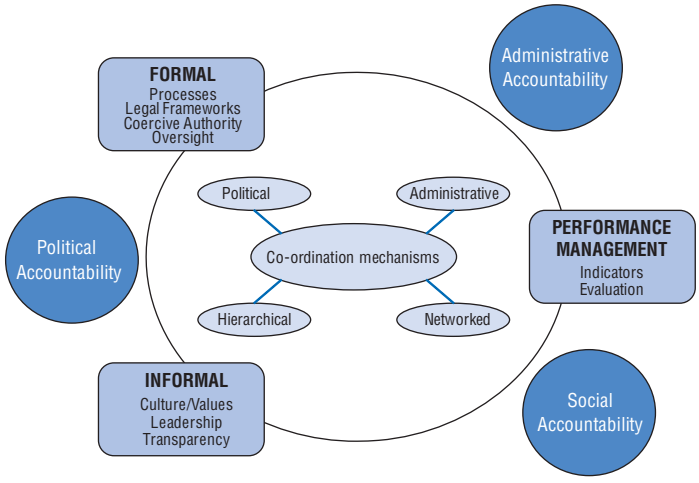
The elements of a "whole-of-government" approach

The ways to implement and practice a whole-of-government approach in public administration vary based on country experiences and contexts. Thus, there is no single approach – but rather a spectrum of practices with countries each developing and adapting its use as appropriate to their circumstances. Some have integrated the whole-of-government concept extensively into their working method and culture *(e.g.,* Australia, New Zealand, Sweden and the UK), while others have put co-ordination elements in place to support such a way of working, without a formally articulated intention to make it more far reaching.

The concept of public governance provides a useful framework for identifying the key levers for achieving a whole-of-government approach and understanding the elements of whole-of-government working. This approach brings out the different systemic elements that shape decision making and action, and that need to be addressed in order to promote greater horizontality: formal and informal working methods and relationships are linked, as are political and administrative levers, ownership of issues, and accountability and co-ordination mechanisms. Accountability in its various forms – political, administrative, and social – provides boundaries and incentives for action and behaviour.

Most public administrations have hybrid governance systems, combining hierarchical (*i.e.*, driven from the top or Centre of Government) and networked (*i.e.*, distributed across individual and institutional nodes) structures, and formal and informal mechanisms for co-ordination and decision making. Each element forms part of a whole in order to achieve objectives (see Figure 4.1). Co-ordination mechanisms are central to a well-functioning system, as they bind the other elements together. In addition to being either hierarchical or networked, co-ordination systems also have political (*e.g.*, Cabinet Committees) and administrative (*e.g.*, inter-Ministerial Working Groups) elements.

Figure 4.1. **Systemic elements of public governance**



The backbone of a single government approach to public administration is the establishment of co-operative structures in order to more effectively meet government objectives. These structures can be created by hierarchical pressure or can arise – possibly more effectively – from collegial nurturing and negotiation, driven by informal networks and values. Achieving government objectives utilising hierarchical structures implies gaining agreement among the political and administrative spheres on organisational design or intentional re-organisation, whereas utilising negotiation as a driver accommodates heterogeneity, making room for the assumption that political and administrative actors will have different attitudes *vis-à-vis* public administration reform. Countries appear to strike a balance between these; top-down or mandated structural change, generally associated with strong political will and a central vision, may not always prove sufficient in and of itself for producing results (Christensen and Laegreid, 2007).

Putting a whole-of-government approach into practice

It is important to keep in mind that working as a single government does not necessarily mean becoming a single institution. Rather, working in a whole-of-government manner

means balancing increasing centralisation with decentralisation to achieve a more joined-up public administration. Mechanisms such as co-ordination and collaboration in the public administration, stewardship by the centre, and ministerial accountability are therefore necessary to sustain the principles of participation and devolution, and to ensure that a whole-of-government approach does not automatically lead to greater centralisation. However, while the emphasis in a single government approach is on co-ordination and cross-sectoral working, this will most likely still occur within a framework of sectoral division and specialisation (Christensen and Laegreid, 2006).

A whole-of-government approach is often closely linked to institutionalised or formal support mechanisms. This can mean a Centre of Government with a strong co-ordinating and stewardship mandate, financial management, and stronger governance and accountability frameworks. At the same time, collaboration can also be undertaken in a very practical fashion – in other words, it is not always necessary to wait until institutional frameworks (*e.g.*, mandates, legislation, etc.) or formalised collaboration mechanisms are in place. Whole-of-government approaches can also successfully take advantage of network governance models, as found in a comparative study of service delivery organisations in Australia, the Netherlands, New Zealand and the United Kingdom (Christensen and Laegreid, 2007). Given the robust networks in Estonia's public administration, this can work to its advantage.

In order to strengthen their capacity to operate in a single government fashion, public administrations need to utilise a combination of formal cross-cutting structures and mechanisms, and informal norms such as public service values, to help channel their informal networks in support of government objectives. Among those countries that are explicitly moving towards the use of whole-of-government approaches in their public administrations (*e.g.*, Australia, Canada, the Netherlands, New Zealand, Sweden, and the United Kingdom) there is a growing focus on the importance of informal elements – such as the use of cultural change within the public administration at all levels of government, and as applied to processes and behaviour. This includes the use of a strong and unified set of values, values-based management, trust, collaboration, team building, involvement of outside stakeholders, and improved capability (*e.g.*, training and self development) of public servants (Christensen and Laegreid, 2007). Such shifts in organisational culture require leadership, openness to change, and standard setting (*e.g.*, clarifying expectations of behaviour and collaboration in the public administration, as well as the common language for collaboration).

Of equal importance are performance measurement systems that provide a common language across organisations on performance expectations and results. Opening performance discussions with politicians and civil society helps to maintain a focus on horizontal societal outcomes rather than silo-ed administrative outputs. In a whole-of-government system, balance must be struck between the hierarchical and networked, as well as formal and informal processes. The equilibrium point will vary by country, by policy initiative and over time.

Finally, in many countries, governments may focus on immediately actionable election cycle programmes. Making a single government approach operational involves "buy-in" across party lines and by public servants at all levels. This requires political will and leadership that can separate a clear policy agenda from the means to achieving it, *e.g.*, a public administration working in a whole-of-government fashion. Gathering support for a whole-of-government approach involves a combination of short-term wins in order to build

and maintain momentum, while keeping a longer-term vision in place to reinforce the public administration across election cycles. Such commitment is illustrated by Finland, which has consistently and systematically benefited from a steady and long-term plan to move towards a whole-of-government approach through the use of its Government Programme.

The seeds of a single government approach in Estonia

Estonia, like other countries, has a combination of governance frameworks in place – formally, the system is hierarchical with strong ministerial autonomy and independence; and informally, the system is networked, where these networks play a central role in "getting the story" on what is happening in other ministries, to launch initiatives or to implement projects. This means that social capital[1] is essential in order to build and utilise cross-organisational linkages, and needs to run high for an individual to be effective within Estonia's public administration.

Estonia's governance structure is founded on a system of independent ministries, each responsible completely for its own area of competence. This has resulted in strong silos, a formal vertical governance framework, and a high degree of fragmentation which can negatively affect government operations and management, policy development and service delivery. The Prime Minister's role is one among equals. The Government Office which supports the Prime Minister and Cabinet, together with the Ministry of Finance, represents the Centre of Government. Estonia has shown its capacity for horizontal working at both the political and administrative levels, as evidenced during the global financial and economic crisis (see Box 4.2). However, this ability to come together collectively shines more in times of crisis or when a more immediate policy response is needed. The Estonian government now must learn to build this capacity in every-day activities.

Box 4.2. **Responding to the global financial and economic crisis at the Cabinet level in Estonia**

In responding to the global financial and economic crisis, three supplementary budgets representing 9.3% of GDP were passed in 2009, of which approximately one-half concerned expenditure, including decreases in social benefits, consolidation of public functions, and a half-percentage point reduction in the rate of residential income tax re-distributed to municipalities. Increases were also made to VAT and excise duties.

The Cabinet of Ministers took a very active role in discussing and deciding these changes, and, by many accounts, participated in the budget decision-making process down to a very detailed level. Budget negotiations took place at two levels: among public servants, and then at the ministerial level. Regular meetings also took place between financial managers to clarify the position of the state's finances. The Cabinet met to discuss the 2009 Budget in 37 meetings, 22 of which took place in 2009. In total, members of the Cabinet spent three full working weeks collaborating on the details of the austerity budget.

Estonian officials report that, for the 2011 Budget, the budget preparation process has returned to the normal procedure, but that Ministers have a greater awareness of budget rules and issues, as well as a greater familiarity with performance indicators and methodologies (*e.g.,* the impact of cuts in their areas) than before the economic crisis.

Source: Ministry of Finance of Estonia (2010), *Public Service Yearbook 2009,* Ministry of Finance of the Republic of Estonia, Tallinn; OECD interviews.

Estonia now needs to transform its capacity to work in a joined-up fashion into an every-day mode of operation if it wishes to move towards a single government approach. Today, horizontality in Estonia rests strongly on informal networks and practices. This characteristic of small states can be very effective, especially in times of crisis, but has some inherent weaknesses which should be complemented with institutionalised processes. Moving towards a single government approach to public administration and service delivery means building on existing strengths, such as informality, flexibility, and responsiveness, while shoring up weaknesses, for instance individual conflicts, inertia, and *ad hoc* processes. In Estonia this will require:

1. promoting whole-of-government co-ordination, co-operation and collaboration;
2. creating a supporting organisational culture;
3. building a flexible public administration;
4. taking a whole-of-government approach to the state public administration.

Promoting co-ordination, co-operation and collaboration in the public administration

The ability of actors within the public administration to co-operate and collaborate in a co-ordinated manner will be a key element for achieving a single approach to government. At the administrative level in Estonia, the decentralisation of power among ministries and sector portfolios is reinforced through budget and strategic planning frameworks. The fragmentation in co-ordinated policy development that can result from such decentralisation is overcome by relying on informal networks and personal relationships (see Chapter 3). In many ways, this is normal for a small country which is wary of building co-ordination structures that increase bureaucracy, increase administrative burden, or engender "co-ordination fatigue." Some senior officials, however, have raised the difficulty within the existing system to move beyond co-ordination (*i.e.,* shared information) to co-operation and collaboration, (*i.e.,* joint action) (see Box 4.3).

Box 4.3. **Co-ordination, co-operation, collaboration: A definition of terms**

Co-ordination: Joint or shared information insured by information flows among organisations. "Co-ordination" implies a particular architecture in the relationship between organisations (either *centralised* or *peer-to-peer* and either *direct* or *indirect*), but not how the information is used.

Co-operation: Joint intent on the part of individual organisations. "Co-operation" implies joint action, but does not address the organisations' relationships with one another.

Collaboration: Co-operation (joint intent) together with direct peer-to-peer communications among organisations. "Collaboration" implies both joint action and a structured relationship between organisations.

Source: OECD (2005b), *E-Government for Better Government*, OECD, Paris.

The danger Estonia faces in a system with informal co-ordination but few collaboration frameworks is overlap, inefficiency, and a risk of reduced effectiveness in terms of desired outcomes. This holds true for both the political and administrative spheres. The question then is how to ensure collaboration and co-operation – regardless of whether it is

undertaken formally or informally. And who creates the enabling environment – in terms of setting basic rules for engagement; establishing responsibility and accountability; and providing oversight? As ministries have sectoral responsibilities, how can a broad vision of what is being developed sectorally, and especially horizontally, be maintained? And how to ensure that initiatives undertaken best serve to advance the government programme and meet government objectives?

A single government approach will require that the public administration expand its capacity to work in a coherent fashion formally as well as informally. This applies to collaboration across ministries, between ministries and agencies, among agencies, and with sub-national partners. Thus, the government should focus on how to best make existing structures and co-ordination tools more effective, building on the informal structural elements that have worked well to-date, and reinforcing these with more formalised processes. Here is where Estonia can leverage its skill in building and maintaining networks.

Developing a networked public administration

Using a network approach focuses on and encourages both formal and informal contacts across the public service, building on current practices for problem solving in Estonia. Networks reinforce rather than bypass the public policy cycle, ensuring that public outputs, including public services delivered to citizens, are consistent with strategies that support the stated intentions of policy makers. As discussed in the previous chapter, the Estonian public administration tends to depend on informal and personal networks. In and of themselves, informal networks are highly positive. They facilitate an exchange of ideas and knowledge that can enhance innovation capacity. Often the information and knowledge needed to identify and understand emerging trends rests in networks outside of the government sphere, for example in the private sector, academia and non-government organisations, and thus can be tapped into via existing personal or institutional relationships – both those that are close, and those that are more removed.

Thanks in part to its networks, Estonia has demonstrated its ability to address complex problems, such as back-to-back economic and financial crises. In order to keep building this innovative capacity, however, the government needs to be more inclusive, *i.e.,* more willing to draw more broadly on knowledge, experience and perspectives, including of non-government actors and society as a whole. Networks of relevant ministry actors, agencies, local authorities, and external actors *(e.g.,* the national municipal associations or academics, civil society organisations, social partners, etc.), can pool practical knowledge, use it to identify and anticipate policy issues, and come together to develop a consensus position. This can lead to more innovative solutions with greater societal commitment behind them.

Harnessing social innovation and social networks, and promoting the development of social capital are all ways that new and dynamic solutions to existing problems can be found. In the government arena this means tapping into and using the power of networks to connect diverse stakeholders with problems and solutions in order to build results. This can help governments move from a state of "reactiveness" to a problem to one where the ability to draw upon sources of innovation in order to adapt and build a solution is exercised (Bourgon, 2010) (see also Chapter 5: "Building a Common Agenda").

Institutionalising networks

Networks are dynamic, creating links to a diverse set of entities, be they individuals, organisations or institutions. In the aggregate, however, individual networks are only as strong and beneficial to an institution as the tenure of the person with which they are associated. Thus, they are easily fragmented if relationships break, either within the network, or between the individual and the organisation. This puts greater weight on informality, which can prevent embedding some important networks in organisational working methods and lead to weakened governance structures. While informality may be highly desirable for its dynamic and often innovative qualities, a networked public administration requires a balance between institutionalised and informal relations. Taking a networked approach to problem solving, and building a more networked public administration could be a step towards finding this balance.

The EU Secretariat provides a good example of how networks can be institutionalised at both the leadership and technical levels (see Box 4.4). Many of the innovations in the EU Secretariat have resulted from the personal commitment of the Secretariat Director, however, and many administrative and legal barriers to this type of work remain. These will need to be addressed in order to consolidate the practice of horizontal networking and to make it integral to the Secretariat's culture in the long term (see discussion on a mobile workforce later in this chapter).

Box 4.4. **Institutionalising networks: The example of Estonia's EU Secretariat**

In order to co-ordinate EU affairs, the EU Secretariat in the Government Office has established a horizontal council of high-level civil servants to discuss EU matters. Its goal is to achieve coherence at the EU level so that Estonia speaks with a single voice, and to improve efficiency in policy development so that EU policy-making processes can be influenced early on. Part of the Secretariat's working culture is to engage with Parliament, and to work in close co-operation with other ministries. In addition, as a means to build a collaborative culture, the Unit began to rotate its staff through the EU department of the Ministry of Foreign Affairs, and also started rotating in staff from the Ministry of Foreign Affairs and other ministries. Thus, for example, deputies of the EU Secretariat have come from the Ministry of Foreign Affairs, and the fisheries and agriculture counsellor will come from the Ministry of Agriculture. The Secretariat is trying to establish this form of staff exchange with the Ministries of Economy and Communications, Finance, and Justice as well. While it does build and reinforce personal networks, it is also very clearly building an institutional network across relevant ministries and agencies in the Estonian public administration.

Source: OECD interviews.

The risks associated with a heavy reliance on informal personal networks can be minimised by complementing them with institutional networks. This entails embedding networks more formally in the administrative culture. Institutionalised networks are a means to build an organisation's social capital, where ties are formed between the institution and government bodies, civil society groups, thought leaders, individuals, etc. Links within and among institutionalised networks are maintained even when individuals leave the organisation. Since 2004, New Zealand has instituted a number of networks and teams to improve whole-of-government co-ordination across sectoral areas. The creation

of "circuit breaker" teams, and "soft-" and "hard-"wired networks have been regarded as an innovative response to fragmentation and silo-based working. The Estonian EU Secretariat's success in effectively co-ordinating EU affairs policy and building collaboration and co-operation with relevant ministries should be used as an example in other priority policy areas within the public administration.

Making full use of institutionalised networks depends on ensuring that the right people with the right skill sets are in the right place at the right time (capacity), that appropriate information and systems are in place to ensure services are effectively delivered (performance), and that focus on the needs of the end consumer is maintained (citizen focus). It also depends on a coherence of vision by, and appropriate interaction of, institutional actors within and outside the public service. As examined in the context of the Irish public administration, but also applicable to Estonia and other countries, "the quality of governance in public administration will be improved if more effective mechanisms can be found to ensure that the political intent (the articulation of political priorities), and the subsequent implementation of derived actions (strategy and business planning) are more directly aligned." (OECD, 2008e).

Given the increasing attention to and need for horizontal solutions to address policy issues – such as those relating to social services, education, health, environment, competitiveness, etc. – Estonia needs to identify new ways to incentivise the public administration, especially the Secretaries General and Deputy Secretaries General, to work in an integrated manner. Significantly, however, creating incentives for horizontal work necessitates a clearly defined objective to be met at the whole-of-government level, for example articulated through a government programme. In the current government period, such a programme was developed and carried political and administrative weight up until the global financial and economic crisis. After the re-prioritisation that Estonia and many countries underwent in order to manage changed circumstances, Estonia's Government Programme lost this weight and was, for all practical purposes, set aside and not updated. If the Government Programme of the next government period can regain its value as a beacon for government priorities and objectives, it would provide a major guideline for moving towards a single government approach (see Chapter 5: "Building a Common Agenda").

Networks require the alignment of vision and objectives that are based on an integrated approach to leadership (both within the centre and across the public administration), greater consistency across the strategic documents that lay out the intentions and blueprint for public action, and more effective communication across all levels of government on how to meet policy objectives and improve programme effectiveness (OECD, 2008e). Currently, Estonia's approach to strategic planning is document-based and fragmented (see Chapter 5: "Building a Common Agenda"). The Government Programme is developed but has not been updated since the crisis, and there are over 100 sectoral strategic plans, many of which are not followed through. Thus a lack of co-ordination is also evident in Estonia's management of strategic plans.

A weak link in Estonia is consensus and alignment around societal goals, since these have not been clearly articulated within the government, much less to a broader constituency (see Chapter 5: "Building a Common Agenda"). This has permitted ministries to look inward and focus on their core functions, rather than outward as a means to address their sectoral aims while also building synergies with peers and contributing to peripheral but relevant initiatives.

Stewardship for co-ordinated action among hierarchies and networks

In hierarchical systems, decisions flow from the top down, and in such cases, the Centre pulls together and integrates central government policy. In bottom-up systems, government agencies or other relevant bodies work with the Centre and undertake the task most aligned to their sectoral expertise, pooling risk and building scale. In such cases the Centre acts as the arbiter of conflict between the different bodies or nodes of activity (OECD, 2010f). Top-down co-ordination is not within the Estonian ethic or within the Government's capacity. An entirely bottom-up approach, however, is not structurally appropriate and would lack the impetus needed to drive action.

Estonia needs a networked approach to co-ordination. Within the flatter, network theory of policy making, the relevant ministry assumes responsibility for ensuring co-ordination of effort and appropriate resource management in cross-sectoral initiatives, as experienced in Estonia and other countries such as Finland. Success often depends on many factors that can be politically and administratively elusive, including clarity of mandate, incentive, and resources.

No system is entirely hierarchical or entirely networked, and action within a hybrid governance structure requires a nuanced and adaptable approach. This can mean enabling fluid leadership to take root among relevant actors, on a sector or policy-by-policy basis. Such an approach may help Estonia to compensate for the strong decentralisation of sectoral responsibilities.

The strategic role of the Centre

A more coherent framework for network-based action could be achieved by strengthening the stewardship capacity of the Centre – *i.e.,* its ability to supervise and manage all the elements of government placed in its care, including the Government Programme and its objectives, and the public administration. Significantly, the role of the steward is not to direct or control, but rather to guide and co-ordinate. Accomplishing this will require accessible guidance and clear communication from the Centre, stronger co-ordination, and clearly established lines of accountability. In this way the Centre can also better support sectoral policy coherence, which is currently low. Complementing this could be a combined political/administrative co-ordination mechanism based on a "federated" system in which Secretary Generals and Deputy Secretary Generals take a more active role in spearheading and co-ordinating initiatives.

While in parliamentary systems responsibility for policy, including policy co-ordination, generally rests with the Prime Minister's office, the Cabinet can represent a focal point for managing cross-sectoral policy matters (Peters, 1998). Because ministers will tend to put their own ministerial interests ahead of the whole, using the Cabinet as the entity to evaluate horizontal matters will work best if there is leadership that keeps in mind the overall government programme (*i.e.,* the Prime Minister), on the one hand, and leadership that has perspective on policy implementation (*i.e.,* the Government Office/ public administration) on the other (see Table 4.1). In this way, stewardship from the Centre promotes a coherent perspective in policy initiatives while also respecting the individual objectives of line ministries.

There are examples in Estonia of the Centre successfully leading change in a horizontal fashion *(e.g.,* on pensions and labour contract reform). Given the relative newness of the state, the relationship at the Centre, particularly between the Government

Table 4.1. **Administrative elements of government stewardship**

Roles	Hard levers	Soft levers
Adapting	Government Programme and budget; resource and strategic planning	Engagement/consultation/participation; research and analysis; forecasting; horizon scanning
Convening	Budget and labour negotiations	Engagement/consultation/participation; communications
Vision	Agenda and strategy setting; prioritisation	Engagement/consultation/participation; communications; standards (*e.g.,* customer service charters)
Shepherding	Regulation; budget setting; tools and frameworks	Moral suasion (*e.g.,* "bully pulpit"); setting values framework for public service (*e.g.,* codes of conduct)
Openness and transparency	Reporting (*e.g.,* annual reports); freedom	Availability and accessibility of information and of information requirements
Monitoring	Performance management, evaluation; *Ombudsmen*	Public transparency through media; quality control standards/feedback; *Ombudsmen*
Course-correcting	Performance budgeting; programme review	Continuous internal engagement and consultation

Source: OECD (2010), *OECD Public Governance Reviews: Finland: Working Together to Sustain Success*, OECD, Paris.

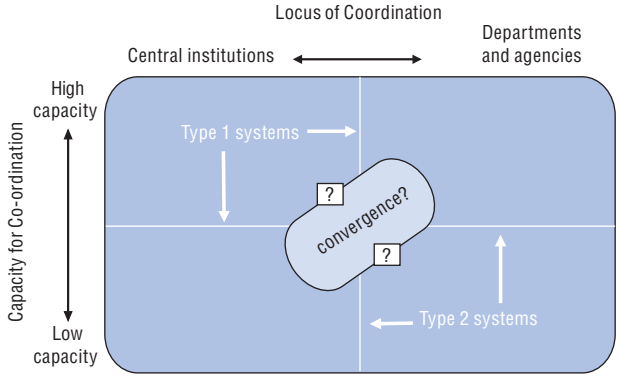
Office and the Ministry of Finance is still being solidified. The Ministry of Finance has the most direct leverage over the central and sub-national level in its role as the "keeper" of the budget. The Government Office has a less direct, but no less important, role: convening actors, initiating dialogue and communicating policy priorities and successes. It has divested most of its operational responsibilities to the Ministry of Finance (*e.g.,* for workforce development), in order to focus on a stewardship role. The intention is to build the Government Office's capacity to guide and oversee the public administration. In order for it to succeed, it will need to address the questions raised above, playing a role in ensuring that inter-ministerial collaboration and co-operation occur when appropriate, and establishing the framework as well as the responsibility and mandate for co-ordination oversight, particularly in cross-sectoral initiatives. Hence, it needs to maintain linkages to the ministries, not just through the Cabinet process, but also via the public administration by reinforcing mechanisms that promote co-ordination, collaboration and co-operation across the public administration. This means continuing the development of a sustained and closely aligned partnership with the Ministry of Finance, as well as maintaining some of its own analytical capacity for strategic planning.

Within a whole-of-government approach, the alignment between where co-ordination happens and the ability to co-ordinate becomes especially critical. It is not necessarily up to the Centre to co-ordinate the implementation of all policy initiatives. The Centre should be able to guide and co-ordinate policy development as a means to ensure that government objectives are met. Meanwhile, responsibility for achieving outcomes and the co-ordination required to do so can rest with the clearly established leader associated with a specific initiative, for example the most relevant line ministry. In such a structure, networks would allow for a more integrated, targeted focus on achieving prescribed outcomes by relevant players. Networks do not necessarily have to be formed or managed by the Centre, though the Centre could be a member of any number of appropriate networks. In order to be most effective, however, members of networks should ideally have the autonomy or authority to make and take decisions (OECD, 2008e).

An early review of responsibility for horizontal co-ordination within OECD governments identified two broad system types in place. Type 1 systems are those that centralise co-ordination and administrative policy functions at the Centre, thereby

reinforcing strong Centres. Countries in this category include Australia, Canada, New Zealand and the UK. Type 2 systems generally have small central institutions; authority for policy and administrative development and co-ordination is distributed to ministries (departments) and agencies. In this model, countries such as Germany, the Netherlands and Norway are found. Figure 4.2 represents these possibilities in a simple two-dimensional structure. One dimension illustrates that the dominance of Centre of Government institutions over ministries and agencies can vary. The other dimension shows that responsibility for co-ordination across ministries and agencies can rest with the Centre or be distributed among different government entities, the latter resulting in a need for mutual adjustment (OECD, 2000).

Figure 4.2. **Responsibility for co-ordinating horizontal issues**



Source: OECD (2000), *Government of the Future*, OECD, Paris.

Estonia's Centre of Government is facing two challenges. First is to decide whether or not, in its movement towards a single government approach, it wishes to function in a "Type 1" fashion, meaning stronger co-ordination from central institutions (though not necessarily greater centralisation), or if it would rather stay where it is at the moment which is closer to "Type 2" systems. If the former, then it would need to strongly consider structural changes in its governance system; if the latter, then it should focus very strongly on changing organisational culture, which means changing attitudes and behaviours.

Striking a balance between an existing "Type 2" framework and what appears to be a desire for "Type 1" levels of co-ordination will require re-examining the roles and function of the civil service and determining how the authority of the Public Service as a whole can be strengthened by building and reinforcing networks. Frameworks and mechanisms are needed to focus the public administration on improving performance, moving towards a single government approach and giving it ownership of broader outcomes. Ensuring the development and implementation of these forms part of the Centre's stewardship role including:

- providing a strategic overview of governmental policy activities, including a foresight function aimed at identifying emerging issues and building anticipatory capacity;
- increasing policy coherence by ensuring that all relevant interests are involved at the appropriate stages of policy development;

- communicating policy decisions to all concerned players and providing implementation oversight;
- applying effective regimes of performance management and policy evaluation; and
- ensuring consistency and coherence in how policies are debated internally, and delivered to the public.

The second challenge facing Estonia's Centre of Government, especially its Government Office, is that there is little it can do to improve ministerial performance beyond identifying potential policy incoherence with government priorities and providing counsel. This can make accomplishing a whole-of-government approach difficult, regardless if applied to a horizontal policy matter or to the overall government functioning. There is a need to build accountability mechanisms wherein ministries are held accountable for their performance sectorally and *vis-à-vis* overall (horizontal) government objectives. This links both to issues surrounding practical "leadership" *versus* oversight of a network and its outputs.

As will be explored in Chapter 5: "Building a Common Agenda", the Centre has a role to play in identifying and negotiating the broad societal goals that can inform and guide the activities of the rest of the public administration. This entails leading work on developing measures, putting performance management systems in place, and communicating outcomes to stakeholders and the general public.

The alignment of political intent, strategy and business planning, and service delivery needs to be supported structurally, financially and culturally, and reinforced in terms of vertical and horizontal coherence. For example, establishing effective arrangements between ministries would ensure greater coherence of approach in order to avoid fragmented or poorly delivered services, and to meet citizen expectations (OECD, 2008e).

Achieving these changes, negotiating trade-offs, and communicating the results to the public are part of the strategic and stewardship role of the Centre. As part of its activity the Centre must anticipate and create appropriate governance structures, while also providing policy advice and guidance, and initiating and driving change, including a single government agenda, as both an instigator and facilitator (OECD, 2008e).

Accountability for and in the "whole-of-government" system

All of government has the responsibility to "answer" for its actions, be it to other parts of government, to stakeholders, or most importantly to citizens and civil society. Administrative accountability can be linked to formal processes and performance measurement. Political accountability is managed between politicians and their parties, and by the democratic process – as it is also embedded in the ability of politicians to deliver on promises made to constituents. However, there is little within the structure that ensures the accountability of the informal elements. In whole-of-government systems, therefore, accountability can be a concern. This arises from an apparent contradiction between establishing joint action, common standards and shared services, and ministry (*i.e.,* vertical) accountability for its performance, as well as those of its subordinate bodies. While tools such as performance management can be of value, in addition to structural and cultural adjustments, a government that functions in a joined-up manner may require changes to its accountability systems (Christensen and Laegreid, 2007).

Part of the matter lies in the fact that networks are not answerable to any single person or institution, and that informal and personal elements are not co-ordinated. Actions or policies that are developed in this domain could be interpreted as non-transparent at best

and an abuse of power at worst. Thus, building accountability structures – political, administrative and social – becomes critical as a means for holding informal actions and decisions up to scrutiny, directed most often by culture and values. This can happen both within an organisation, as well as at a society-wide level. In a situation where social accountability guides networks and their activities, lead actors or network nodes assume the responsibility for the action or decisions of the whole and are also responsible for accounting for their actions.

In a whole-of-government system the question of accountability is two-fold. First, there is the matter of determining who is the torch-bearer mandated to consistently promote a single government approach and ensure that action aligns to it. This does not mean centralising power into one government entity. Rather, it means identifying the institution that acts as steward, charged with ensuring that the perspective of the whole is maintained while leaving room for line ministries to operate, develop and implement policy in their areas of specialty. Such an institution must also be able to develop and promote co-ordination mechanisms that can be applied across the government, monitor outcomes, and make adjustments when necessary. The role of steward can differ according to the sector or target area/population. For the Government Programme, Estonia's Government Office has whole-of-government responsibility.

The second matter with respect to accountability in a whole-of-government system is ensuring sectoral accountability for policy initiatives. If everyone has some degree of responsibility for the policy measure, then who is ultimately responsible? This can be addressed in a default fashion – *i.e.,* the initiating or most competent ministry – or it can be established in a manner undertaken by Canada when it addressed the threat of the H1N1 virus. The Cabinet Office delegated the responsibility of driving the co-ordination process to the Department of Health, which drove a whole-of-government response. While this does not seem so far-fetched, H1N1 being a health-related issue, given the broad scope of the problem and the number of Departments involved, there was room for the Cabinet Office to lead the response, which it chose not to do. However, it did take the lead in identifying which department would be responsible, giving it a mandate and decision-making authority. The method worked because accountability – *i.e.,* who was responsible for what – was clearly established.

Another example is the Irish Office of the Minister for Children and Youth Affairs, which represents an innovative model for ensuring greater coherence in policy making and service delivery from a whole-of-public-service viewpoint. The Office was established to ensure policy cohesion on issues impacting children, encompassing such areas as early childhood care and education, youth justice, child welfare and protection, child and young people's participation in civic society, research on children and young people, youth work, and cross-cutting initiatives for children. In this case, accountability continues to reside with the Ministries who own the relevant portfolios, *i.e.,* the Departments of Health and Children; of Justice, Equality and Law Reform; and of Education and Science, but by co-locating staff around common issues and target populations, the Irish Government seeks to encourage them to approach policy issues in a joined-up way, linking sectoral accountability with cross-cutting thinking and action (Department of Health and Children, 2010).

Performance measurement to improve accountability and incentives in joined-up activity

Performance measurement, particularly with respect to outputs and outcomes, can help build support for greater co-ordination in public administration activities, and a single

government approach. As an *ex post* activity it can facilitate the dissemination of information within government, help actors identify objectives, and improve strategic effectiveness. Without performance measurement systems in place it is difficult to establish accountability and incentive structures at all, let alone for achieving horizontal objectives. A lack of performance measurement can impact budget management or understanding certain policy outcomes at the central level, just as it can affect the use of grants at the sub-national level. Incentive mechanisms are strikingly absent in Estonian public management, and more robust performance measurement practices could help overcome this deficit (see Chapter 5: "Building a Common Agenda").

The links between performance measurement – where "what is possible" has been established – and performance management – where "what is expected" is articulated – are weakened and can create unrealistic objectives and/or expectations. This is particularly the case when there is a breakdown in performance dialogue between ministries and their agencies, or when such dialogue does not exist. Performance dialogue is currently missing in Estonia, and with it, the link between societal and government goals (see Chapter 5: "Building a Common Agenda").

When moving from experimentation to implementation, as in the case of pilot programmes, relevant evaluations that can be used in decision making and programme adjustment are also critical. This is particularly true for horizontal initiatives that need to be tested first in order to assess and map out the complex interplay between sectoral interventions and shared accountability for outcomes. Performance measurement systems can address this need. Indicators can stimulate and focus actors' efforts in critical areas, create a basis for identifying and disseminating good practice, create a common language that can form a foundation for co-operation, and even incite constructive competition to drive productivity and innovation. Like formal processes, performance measurement systems help to promote capacity development and good management practices.

Other mechanisms to strengthen networks and build co-ordination capacity

Working Groups

With cross-sectoral policies (those that cut across the functional responsibility of a number of ministries or departments), it can be difficult to determine who is the overarching leader of the initiative. In order to help clarify accountability, and also to ensure coherence and strategic integration in priority policy areas, inter-departmental or cross-functional committees can be useful.

In Estonia, many cross-sectoral groups have been established in the form of working groups, committees, councils, etc. Estonia's impressive ability to establish working groups includes pilot projects in the public administration, drafting policy reform and legislation *(e.g.,* the Employment Contract Law), processes and systems *(e.g.,* sustainable development indicators), sub-national negotiations, and international initiatives. Often these are populated with a wide array of appropriate stakeholders, providing a more structured way to tap into individual personal or professional networks, both inside and outside of government. It is important to ensure, however, that these groups do not become "exclusive" and that they remain open to voices of dissent. One of the responsibilities of working groups as a co-ordination mechanism is precisely to listen to a variety of perspectives, synthesise these, apply them as appropriate to create stronger and more sustainable results, and then move forward with the initiative.

The use of working groups in Estonia may be evidence of attempts to create or harness the power of networks. While networks are key in bringing peer groups and diverse stakeholders together, they are not the same as working groups. Both can play a role in building the co-operative capacity of the Estonian public administration, but where networks are sources of exchange, dialogue, information, feedback, and innovation capacity – and are able to expand and contract as needed – working groups are more formal bodies, established to accomplish a well-defined objective by a set of relevant stakeholders. Networks can generate ideas, working groups can translate them into policy.

Public administration networks could be further supported by working groups established on an *ad hoc*/as needed basis whose life spans the time necessary to solve the identified problem and accomplish the stated objectives (OECD, 2008e). Possibly under the auspices of the network, working groups could articulate the strategy and identify appropriate tactics to address the problem, and develop an implementation and resource plan to achieve agreed-upon outcomes. In a complementary fashion, advisory committees can provide *ad hoc* programme co-ordination mechanisms, bringing in diverse perspectives from a wide range of stakeholders (*i.e.,* representatives from other organisations, internal and external to government, including civil society when appropriate) without increasing the amount of "co-ordination bureaucracy". Norwegian ministries, for example, have had experience working with advisory committees (one per ministry) where various interest groups and other concerned or relevant government departments were also present. These committees would review major policy initiatives. The value to such a method is an ability to keep various ministries informed of activities that may impact them and to raise issues that could be worked out prior to the policy's implementation (Peters, 1998).

While the ability to establish co-ordination mechanisms is present in the Estonian public administration, it has also been reported that sustaining such groups or their work over time is difficult. This may be due, in part, to an enthusiasm for establishing working groups whenever an issue arises, rather than identifying when a working group is an appropriate structure to resolve a problem. It can also be the result of a system that is comfortable with using working groups as a means to build buy-in for strategic outputs, but which simultaneously suffers from "strategy-document fatigue" resulting from bringing people together to develop yet another strategic document that may or may not be acted upon.

Inter-ministerial groups for cross-sectoral initiatives do not have to be indefinitely established to be successful. The group that came together from the Ministry of Justice and Ministry of Social Affairs to draft the new employment legislation is an example. They can remain *ad hoc*, composed for the purpose of a specific policy initiative; but care should be taken that, for the period of their lifetime, there are formal co-ordination mechanisms associated with their activities. This can include regular meetings, establishing and circulating agendas, and disseminating to group members (and possibly other stakeholders when appropriate) the outcomes and decisions taken in a meeting in a written format. Another advantage to written communication is that it helps establish a group understanding of the decisions taken, as well as any associated activities and responsibilities for action.

For a working group to be effective its mandate needs to be clear, and there should be some formal processes in place, including a timeframe for its mandate, well-established roles and responsibilities of the various members, articulated milestones, and documented and communicated decisions and outcomes. Working groups are also most effective when the issue at hand can be clearly defined, as they have the advantage of providing a specific focus on a matter for discussion.

Knowledge management and communities of practice

Networks are strong generators of knowledge, which can serve individuals, the public administration, and society as a whole. One challenge is to manage the information and ideas that arise from network activity, and the other is to communicate them. Given the strength of and reliance on networks within Estonia's government, thought should be given to knowledge management and knowledge management systems (see Box 4.5).

Box 4.5. **What is knowledge management?**

Knowledge management is an often-used, but vague, term which has been defined in a variety of manners. Broadly it can be considered a process of optimising the application of human intellectual capital in order to achieve organisational goals (OECD, 2001b). It can also be conceived of as a process through which organisations generate value from their intellectual and knowledge-based assets. Most often, generating value from such assets involves codifying what employees, partners and customers know, and sharing that information among employees and departments and with other organisations *(e.g.,* ministries, agencies, local authorities), in an effort to identify or develop good practices.

Knowledge management involves adapting classic management tools systematically to promote knowledge sharing, including:*

- Improving human and social capital by: *i*) flattening rigid pyramidal hierarchies and opening up bureaucratic divisions to promote horizontal knowledge-sharing; *ii*) linking performance pay and promotion to knowledge-sharing; *iii*) building communities of practices (group of practitioners sharing their knowledge in a specific area without working on the same specific project).
- Adapting corporate/organisational capital, *i.e.,* databases, websites, intranets, social events, knowledge workers and knowledge central co-ordinating units.
- Building stakeholder (citizens, users, private firms, lobby groups, etc.) capital by: *i*) obtaining the right knowledge on all stakeholders; *ii*) involving stakeholders in the decision-making process.
- Strengthening connections with private firms, research institutes, universities, etc.

* This classification is in part inspired by the one quoted by David Stephens, in "Intellectual Capital: Asset for the 21st Century Public Sector", paper prepared for the IPAA Conference "Five + Years of Reform", Canberra, 20 November 2000, from Tom Steward's 1997 book entitled *Intellectual Capital*.

Source: Adapted from Levinson, M., *Knowledge Management Definitions and Solutions, www.cio.com/article/40343/Knowledge_Management_Definition_and_Solutions*, accessed on 29 November 2010; OECD (2001), *Knowledge Management: Learning by Comparing Experiences from Private Firms and Public Organisations*, OECD, Paris.

Building and actively using mechanisms for knowledge management can begin institutionalising knowledge, sharing ideas, communicating more broadly, and bridging collaboration gaps across ministries and agencies. Some countries, such as Korea, have established successful knowledge management mechanisms based on dedicated ICT systems. In Estonia, knowledge is often managed more informally, for example through social networking internet platforms *(e.g.,* Facebook, Skype, Twitter, etc.), rather than through formalised means. The critical element of knowledge management particularly among Estonian civil servants lies in ensuring that new ideas, background information, and data are communicated in an up-to-date and accessible fashion up, down and across the public administration. While Estonia may not need a dedicated knowledge management system, it should pay attention to how actively knowledge is communicated among its civil

servants and identify means to strengthen communication channels. Using social networking platforms can be very effective. However, it can also be limited, reaching only those who are directly in a specific network, and may not be accessible to others also seeking knowledge. Internal communication and exchange of knowledge among Estonia's civil servants needs to be strengthened and made more systematic. Networks among Secretaries General and Deputy Secretaries General, as explored later in this chapter, as well as communities of practice, can build knowledge and generate innovation.

Communities of practice are a more formalised type of network among people who share a common interest or participate in a particular subject or activity, who are engaged in improving their knowledge and skills associated with such matters, and who enhance their understanding through regular interaction. Members of such communities are practitioners. Thus in government, communities of practice can be used to build and share knowledge in a particular policy area *(e.g.,* health, education, water). The community can be comprised of government (central and sub-national), non-government and private actors, be they institutional or individual. In this way, a network is established around a topic or an issue, rather than an individual, and those people working on the issue have access to the network. This strengthens the resilience of institutions when individuals leave or move (they can dip into a common and continuous community of practice for shared knowledge). Communities of practice can also facilitate connections between informal and formal structures. Communities of practice allow public administrations to tap into or harness knowledge that is generated and renewed through personal exchange. The Ministry of Finance has made good use of this in its piloting of performance budgeting systems (see Chapter 5: "Building a Common Agenda"). When needed, the knowledge can also be funnelled into a more formal dimension through knowledge management systems, which may facilitate broader dissemination.

Within specific policy areas such as public administration reform, care for the aged, internal security, education, or sustainable development, the Estonian government may wish to experiment with developing and supporting communities of practice to help move policy forward. It should also consider activating and strengthening knowledge management mechanisms which could help Estonia build more effective internal communications.

Establishing internal agreements and formal processes

Formal agreements among government bodies can help articulate the government's expectations for its horizontal priorities, and establish the roles and responsibilities of the relevant actors *(e.g.,* ministries, agencies, levels of government) who have a part in realising these high-level aims. This is, in a sense, one of the roles of Australia's Council of Australian Governments (COAG), where national-level agreements are made on how to achieve cross-cutting national objectives. The agreements are negotiated among the various actors, roles and responsibilities are established, performance indicators identified and expected outputs/outcomes articulated that could be used for performance measurement and evaluation.

Administrative agreements – *e.g.,* among ministries, between ministries and their agencies, or between levels of government – provide a formal means to understand the roles and responsibilities in a collaborative effort. These can take the form of Memorandums of Understanding or Terms of Reference. While more formal and with a legalistic overtone, they can help clearly establish roles and responsibilities, expectations, and desired outcomes. In addition, using template agreements can simplify the logistical obstacles that

can hinder collaboration. Significantly, such agreements do not require legislative changes; nor should they be political declarations with no clear follow-through. Rather, they serve as an accord among relevant parties where responsibilities and expectations are clearly stated, particularly for "gray areas" where responsibility has not been concretely established.

Formal processes and guidelines can also help the public administration's capacity to act in joined-up manner. Such processes serve as a "tool kit" that enables individuals to solve discrete problems using accepted methods that are adaptable to the matter at hand. These processes can include legal frameworks, such as framework agreements for co-operation, ICT procurement guidelines, and basic step-by-step guidelines for action. One good example is the 2005 strategic planning regulation which provided detailed guidance on how to produce strategic plans. It also served to introduce greater coherence to strategic planning and in some cases, for example that of the Ministry of Culture, helped reinforce internal ministry-agency relations and networks (see Box 4.6).

Box 4.6. **Using formal processes to build capacity and collaboration**

The introduction of the strategic planning regulation provided a framework for ministries to better articulate their plans. The Ministry of Culture's experience was that over time its plans became more systematic, transparent, logical and shorter (approximately 30 pages rather than the previous 100+ pages). The Ministry of Culture is Estonia's smallest, with a staff of 50-60 people. It has a broad portfolio and approximately 40 subordinate agencies (including libraries, museums and theatres). Ministry officials realised the need to co-ordinate strategic plans in order to achieve their objectives. Thus, the Ministry developed a simple, clear template and worked with its subordinate organisations in developing their individual plans, guiding them through the full process. The Ministry undertook an intensive period of consultation with the different categories of subordinate agencies, held a kick-off meeting involving all agency staff, and then sponsored a series of development seminars (of approximately 10 people each) which looked at the current situation, objectives, vision, resources, etc. A Ministry representative was on hand at each meeting, and also worked with each organisation to develop its strategy. When the strategy was ready, the agencies customarily held a celebration and launch event where the leaders gave a description of the strategy with the aim of making it "come alive." These agency strategies then were used to feed into the umbrella strategy of the Ministry.

In addition to successfully using and adapting a framework tool, the Ministry of Culture has also been successful in building and institutionalising a network for its museum directors. The network meets regularly, with a well-defined agenda, for professional training and development, as well as to build common ground among the directors, and between the directors and the Ministry. This is an example of both an institutionalised network and a community of practice.

Source: OECD Interviews.

Using ICT to facilitate co-ordinated action

One area with a well-developed system of standards and procedures is that of ICT use in the central administration. Estonia has been a front runner in this area and benefits from a sophisticated ICT infrastructure. The Informatics Council, in particular, has demonstrated how reviewing for redundant data collection efforts helps reduce administrative burden. The more fragmented approach in the development of e-government services, however, shows

that standard processes alone are insufficient and that accountability and incentives are also needed to build cross-government co-ordination and collaboration for the development of e-services (see Chapter 6: "Delivering Public Services Effectively").

Resource capacity is often cited as a reason for lack of horizontal collaboration, but whole-of-government approaches are undertaken precisely to build efficiency by capitalising on synergies, reducing overlap and pooling resources (be it knowledge, funding, staff, or infrastructure). The UK has seen that it can save more by working across government than by having individual units work alone. Thus support is provided to departments to identify ways to reduce costs, (re)negotiate contracts centrally and reform how services are delivered, including new ownership models as a means to improve efficiency.

ICT-enabled networking and inter-connectivity provide new opportunities for identifying and eliminating duplication and redundancies, and for remedying incompatibility of systems and processes across government. Most governments work to identify common business processes, and have or are deliberating measures to standardise and share such processes in areas such as finance, human resources and information technology management, administrative support, legal services, facilities management, travel services, marketing and communication and other similar functions (OECD, 2010f).

Developing shared corporate services can help to promote a whole-of-government way of working. Streamlining and aligning processes and utilising ICT to join-up for various corporate functions can provide efficiencies and increase the effectiveness of service to internal clients (staff) and to the government. Shared services are therefore increasingly being used to bring the over-reliance on decentralisation and devolution back into balance.

Estonia is building corporate or shared administrative services through the Shared Support Services programme, led by the Ministry of Finance for the central level, with a similar programme being implemented at the County level by the Ministry of Interior/Regional and Local Affairs. The Shared Support Services project has strong, two-tiered leadership and support where the Centre of Government (in this case, the Prime Minister) identified the leader of a co-ordinated initiative (here, the Ministry of Finance), empowering it to move forward with programme design, development and implementation (see Box 4.7).

While it has been rolled out with impressive levels of commitment and political support, implementation of the Shared Support Services project could have been improved by taking more time to establish sufficient ties with, and building capacity in, other key ministries and programmes. With respect to linkages to other administrative services, the initiative could have benefited from greater co-ordination with the Ministry of Economy and Communication, which has primary responsibility for the co-ordination of ICT development across the state administration. While this Ministry supports a more decentralised approach to aligning systems, once the government reached a decision to implement shared services, it could have significantly contributed to the Shared Support Services project, drawing on its experience of establishing ICT standards and infrastructure. From a broader perspective, the Shared Support Services initiative would have also benefited from improved planning and sequencing of administrative reforms. For example, as the performance budgeting proposal currently under development will have specific needs for the financial management IT systems currently being rolled out under the shared services initiative, it would have been better to plan and implement the two initiatives on a more co-ordinated timeline.

Box 4.7. **Estonia's Shared Support Services project**

In early 2010, the State administration began operating a project which joins support services (accounting and personnel) across the state administration. Previously, there were 202 accounting entities in Estonia's 242 state agencies, and 15 different versions of accounting software were operating with 150 different set-up versions in use. The aim of the Shared Support Services initiative is to transfer all 242 state agencies to a common information system of financial accounting, personnel records and wage calculation by 2013.

As part of this project, financial accounting, personnel records and wage calculation systems will be transferred to a common SAP software. Before this change, personnel records were usually agency centred, and there was no general overview of personnel for the whole-of-the-administration. For example, there are 100 000 cases of official travel registered per year. In some organisations, this travel is prepared and approved in a records management system which is not linked to financial software, so information first has to be printed out and then re-entered in the financial accounting information system.

The objective of joining information systems in this way is to improve management information, raise effectiveness and obtain a better overview of the state's administrative expenditure. The common software system ensures that state agencies will have information that can be commonly processed and measured, and a full overview of the movement of resources. This will ensure that e-bills, e-documents and web-based accounting systems are processed faster, making information needed for management available in real time. There will be no duplication of work or manual entry of data, since information will move electronically from one programme to another. The accumulation of competence and training of employees will guarantee a uniformly high quality of services. The Ministry of Finance reports that the unification of support services is expected to decrease bureaucracy in records management and render a retrenchment of operating expenditure, enabling the provision of better-quality public services at a lower cost. This translates into a reduction of accounting staff by 10% each year from 2010-13 (thus 40% or from 600 to 360 people), and a reduction in accounting operating costs by 40% over the same period. After four years, the cost of accounting support services is expected to decline by 20-30%. In addition, assuming the implementation of a self-service model, costs related to personnel administration would be expected to reduce by 77% (from 175 people to 40) though the timeframe for this is not specified. The Shared Support Services project is a major initiative with an ambitious timeframe. There has been a promise to deliver a 10% efficiency dividend annually over four years. Savings are expected to be harvested from: 1) optimisation of processes; 2) e-invoicing for procurement of a common SAP system.

The SAP upgrade is already agreed and will occur in 2011. The Ministry of Finance also plans to add to the SAP upgrade in the future by developing the STEP system, which will look at planning and budgeting information (the first stage of the Shared Support Services project only looks at planning information). STEP will take information out of SAP. The hierarchy system developed in strategic planning will set the framework for the STEP system. STEP is said to be needed to support the current budget process – however, agreement is still needed by government before progressing with the development of STEP.

Source: OECD interviews and Ministry of Finance, Estonia.

The first set of ministries responsible for implementing shared services were not brought into the programme development process early on to discuss system design and their institutional needs. Capacity building has been left to the implementing ministries as well, as there has been little consultation, assistance, support or co-ordination for the

delivery of the programme. This may lead to setbacks in implementation, as well as problems in comparability of financial and personnel data across ministries. Some of these efforts are also being duplicated at the county level in a similar programme, already underway. Keeping the central and sub-national needs and development separate is coherent with the logic of independent ministries, and the fact that different ministries are responsible for administrative services at different levels of government. However, developing such projects in a more joined-up fashion may have identified synergies early on and could reduce overlap or redundancy in implementation, resource needs and capacity building exercises (*i.e.*, training), thereby improving both individual implementation by ministry and overall coherence of the public administration.

The shared service approach should be expanded beyond the county level to local authorities as well, where there is an even greater need. Looking at websites of the public financial sector, one-third are state and two-thirds are local. This is indicative of the potential for integration.

Creating a supporting organisational culture

When discussing whole-of-government approaches, OECD countries stress the importance of leadership, the identification and articulation of shared goals, commitment by political and administrative levels over the long term, and the need for clear accountability. Performance management and performance indicators can begin to address these matters, but equally important is cultural change within the public administration. In addition, countries need to be aware that a single government approach is an investment over time, and that there are costs associated with horizontal ways of working which can be time and resource intensive.

A supporting organisational culture underlies the success of a whole-of-government approach. Many of the complex issues facing Estonia now and into the future transcend traditional boundaries. Given the strength of informal networks in Estonia, promoting a networked and horizontal organisational culture among public sector organisations involves reducing silo mentalities and putting these networks at the service of overall government objectives. This can be achieved through effective leadership; building public service values; and strengthening accountability and incentives.

Supporting a whole-of-government approach through effective leadership

Leadership plays a pivotal role in fostering a whole-of-government culture in the public administration. Senior leaders – the shapers and keepers of the public administration's identity – set an example for the rest of the public administration. Thus, collaboration and co-operation among them is critical to a single government approach. The extent to which the Estonian public administration is cohesive and has a broad identity depends largely on its senior leadership, and on how individual leaders understand the broader context of the public service and show real commitment to genuine collaboration and the achievement of joint outcomes.

In a small state such as Estonia, over-reliance on individual, personal networks with strong emphasis on the exercise of informal authority can allow individuals to exert heavy and direct influence on the system. They are also more likely to be personally identified with actions and their results, both positive and negative. Given the pressure this can cause, the result can be an avoidance of decision making, taking the form of delegation up

and/or down. Decision making and policy implementation can also be subject to strong personalities who can stall or neutralise any forward movement if they do not agree with a proposed action. This can leave institutions that have "weak" heads with even less influence. The result is a situation where any one person can be the locus of any system dynamic, potentially leading to a problem of accountability, particularly in the long-term.

As stated earlier, cultural change in support of a whole-of-government approach requires leadership by example. At the administrative level in Estonia this should begin with the Secretaries General (SG), starting with their established Monday meetings. Currently, these meetings serve to work through administrative issues associated with the agenda brought forward for the Thursday Government meetings. However, they also represent an untapped opportunity for building a strong network that can promote and communicate complex reform across the government, within line ministries, and to relevant internal and external stakeholders. As a defined senior network of peers, the SGs are ideally placed to build shared responsibility, promote inter-ministerial co-operation and collaboration, and to build and strengthen links to leadership. Estonia may wish to look at Ireland's High Level Implementation Groups, which serve to institutionalise joint decision making and build a single voice within the public administration. Such cross-sectoral groups may be chaired or co-chaired by Secretaries General on matters ranging from national workplace strategy to innovation to issues concerning foreign relations.

Among the questions facing government with respect to senior leadership and a single government approach are how to: *a)* build the senior leadership, especially when the resource pool is limited; *b)* build the capacities of senior leaders on an ongoing basis; and *c)* ensure that senior leaders make contributions across departments and the civil service. In the UK, this has been addressed by a "Base Camp" – a single government-wide entry course for all new senior leaders. In this course the leadership expectations are articulated based on a horizontal rather than ministerial perspective, thereby planting the seeds for more co-ordinated and collaborative thinking from the beginning of service, reinforcing expectations through performance objectives. In addition, a training programme like this can help nourish the networks that facilitate "getting the job done".

In Canada, a management accountability framework measures Department (Ministry) capacity in 10 key areas including leadership and results. All Departments are assessed against expectations, and the framework plays a pivotal role in performance management bonuses and other elements of pay. A results-based framework such as this can make it easier for people to decide how to achieve objectives, thereby making room for greater innovation (*i.e.,* it is a means to build innovative capacity). Canada has noted that this can be a strong driver for leadership development, cultural change, and innovative thinking, but that care has to be taken to ensure it does not simply become a governance checklist.

High-level inter-ministerial groups can create a sense of ownership and responsibility for a policy matter among relevant SGs, and solidify leadership and accountability. They can also strengthen the shared values set and build trust among potentially divergent interests. Of course, establishing an effective group requires time, practice and capacity. In order to exert the competencies needed to achieve a whole-of-government approach, the public administration's senior leadership needs to commit to its development. In May 2005, the Government Office introduced the Competency Framework of Estonian Senior Civil Service as a tool to support the selection and development of senior executives, in order to ensure achievement of the state's strategic objectives. The key criteria of the competency framework

include: credibility; a strong vision; innovation; leadership; and outcome orientation (Government Office, n.d.). This competency framework is applied to the selection, assessment and development of senior leaders,[2] whose participation is voluntary: approximately 65% of senior leaders are participating in the programme. Estonia should consider extending the competency framework over time to all levels of staff in the public administration and build incentives through performance assessments to motivate participation. This could be modelled on Australia's Integrated Leadership System (ILS), which is an example of an embedded leadership competency framework that underlies recruitment and selection, development and individual performance assessment for all levels of staff.

Networks could also extend to Deputy Secretary Generals (DSGs). While the general feeling is that they may not have the time to spend at a regular weekly meeting, a bi-annual gathering and a dedicated electronic networking site to share experiences for example, could help deepen collective ways of working at all levels, build a common understanding and shared vision of horizontal policy issues, broaden communication channels, and prepare the next generation of senior leaders. Such networks among senior civil servants should also be utilised as fora to develop new ideas and innovative policy solutions, identify policy synergies among various ministerial initiatives, and build dialogue as well as facilitate information exchange. Japan and Ireland have formalised networks at this level.

Finally, in working towards a whole-of-government approach there is a political consideration as well: the behaviour and role of SGs is at least partially linked to the expectations of ministers. Thus, if ministers expect SGs to perform and act in a co-ordinated manner, promote collaboration, and facilitate co-ordination across ministries, they can help create an enabling environment. However, if ministers themselves reinforce silos, are reluctant to share information, and have difficulty making their objectives clear, this impedes more dynamic and effective interaction at the SG level. In particular, working as a single government requires Cabinet consensus and clear room for the public administration to build the administrative platform to deliver on horizontal political objectives.

The political/administrative interface in a whole-of-government context

A well-functioning political/administrative interface is needed in order to fully develop and communicate the vision and strategies associated with joined-up government, as well as a government's overall strategic programme. Within this interface, politicians and senior civil servants have a distinct set of responsibilities and accountabilities. The political level is responsible for indentifying policy issues, designing strategies, setting targets and priorities, formulating responses, allocating resources, making judgements about outcomes and adjusting policies accordingly. Ultimately, they are accountable to the electorate and, on a day-to-day basis, to their elected peers in government. The administrative level provides information, advice, and mechanisms that will facilitate decision making and monitoring. It is also responsible for implementing the policies and managing the day-to-day operations of government, as illustrated by Box 4.8, which provides some examples of these activities. Senior civil servants are accountable to their respective ministers and, in some cases, may also be held accountable to parliamentary committees, while more junior staff are accountable to their senior managers (OECD, 2008e).

There is a sense that many public administration reforms are currently stalled in Estonia. This may be due in part to the fact that public administration reform carries low political weight – citizens are generally not very interested in public administration reform unless it touches upon specific social services, such as healthcare (see Chapter 3: "Public

Box 4.8. **Domains of administrative responsibilities**

- *Priority-setting:* implementing priorities, dealing with emergencies, allocating reserves.
- *Budget-making:* expenditure analysis, production estimates, reserve management.
- *Management innovation:* alternative service delivery mechanisms, departmental assessments, service quality.
- *Human resource management:* collective bargaining, benefits administration, classification, re-deployment, training.
- *Administrative policies:* purchasing, freedom-of-information and privacy, information technology, real-property.
- *Affirmative action:* women, minorities, disabled, aboriginals and sometimes official languages.
- *Financial management:* audit, evaluation, financial control systems, budgetary flexibilities.
- *Legal services:* legal advice, contract management, defending against claims, etc.

Source: OECD (2000), *Government of the Future*, OECD, Paris.

Governance Arrangements in Estonia"). This can translate into low political will for administrative reform, or at least political ambivalence. In Estonia a well defined and integrated public governance agenda is lacking, and the focus is on narrow administrative issues which do not draw political attention. In addition, there appears to be a lack of dialogue between the administrative and political spheres as to what may be necessary in terms of reform.

With some exceptions, politicians are typically more focused on policy objectives and outcomes (the "what"), than on instruments and implementation (the "how"). While the productivity and effectiveness of the public administration should be a high political priority, the building of public administration capacity, *per se*, tends to be more of an administrative preoccupation. A clearer separation of political and administrative functions would continue to permit agenda setting and prioritisation by the political level, but would also make room for the civil service to implement these priorities.

Another reason that public administration reforms have not advanced in Estonia is that senior public servants have not been able to articulate and then communicate to politicians a coherent and unified message about the need and direction for change. Given conflicting signals, politicians have held off committing to some key public administration reforms. To gain support and buy-in at the political level, the public administration's senior leadership needs to communicate its own vision for reform. This requires leaders across the public administration to collaborate in developing a co-ordinated vision or direction for where the public administration should be heading, or for the type of reform necessary, before going forward to government.

The origin of the current dynamic appears to stem more from concerns about the practicability of plans and the capacity of the public service to implement them than from any real differences in political perspective. If indeed there are questions regarding civil service capacity to properly interpret and implement the political vision, then it is critical to build the capacity of the civil service. Otherwise, the circle becomes vicious: the political level gives less responsibility to the public administration, which will grow weaker because its competence is not being built, further reinforcing the political level's impression.

One risk of the current political/administrative dynamic is that civil servants set aside their role of analysing and testing possibilities for innovative policy design and implementation. A low circulation of new ideas or alternative solutions to a policy challenge can result in short-sighted prioritisation in policy making (particularly where success is based on personalism and political acceptability). Trying to appeal to political priorities often means a focus on immediate or short-term issues that can easily "pass" or garner votes. This leaves little room for a long-term perspective in policy initiatives, and given the lack of long-term vision, there is no beacon to guide the administrative level or to provide support to an argument as to why a policy should be implemented. Estonia's success as a country to-date has had much to do with realising its innovative capacity, and therefore it is critical to reduce such a risk.

In Estonia, the public administration and politicians need to strike a balance of roles and responsibilities where the public administration has the flexibility to strengthen its capacity within agreed inputs and under political accountability for the delivery of overall results. Absent this, as is currently the case in Estonia, reforms stall.

Identifying public service values and capabilities

By shaping organisational culture, public service values are a key mechanism for helping the Estonian public administration to work in a whole-of-government manner. Co-operation and collaboration among staff within and across public sector organisations depends on both individual and group commitment in order to achieve a whole-of-government approach to public administration.

Estonia's public administration operates as a decentralised and fragmented system with silo-ed ministries and little mobility between ministries and agencies. Individual organisational activities and allegiances to responsible ministers mean that the public administration does not effectively operate as a single entity or in a whole-of-government manner. For staff within the public administration, tensions between horizontal and vertical cultures have created ambiguity regarding allegiances and shared behaviours. Individuals are conflicted between needing to represent their ministries/agencies while also being mindful of their contribution to the wider whole-of-government agenda and context. This has contributed to a public service ethos where co-operation and partnerships between public service organisations is not recognised as a core value.

While informal networks exist within and across public sector organisations, working in a genuinely collaborative manner on the design, development and implementation of policies and programmes does not come naturally. Shared public service values can help staff to navigate their responsibilities at both the vertical and horizontal levels – to work in the interests of their ministries/agencies, while also being mindful of the broader collective response of the public administration in implementing the government's agenda. Public service values help reflect what the public administration is trying to achieve, and support the design of collective and individual objectives, as well as maintenance of a shared public service culture. A set of core values that are meaningful and memorable and which promote working in a whole-of-government manner can be very effective in helping to drive the change needed in Estonia to work in a more joined-up fashion.

Public service values are concepts and principles which guide the conduct of public servants – they have to do with what is important to people and institutions. Core values are a reference point for staff, and help to give meaning to reforms and to build and

strengthen a sense of community, as well as to foster a shared purpose and way of behaving and working. It should be recognised that public service values are different from public service ethics, which focus more on the fundamental premise of a public servant's ethical responsibilities to the public and are used as justification and consideration for decisions and actions made when undertaking their daily duties (see Box 4.9). On the other hand, values are a translation of a code of ethics into practical behaviour for staff; they embody the shared behaviours by which the public administration operates – which can include working in a whole-of-government manner by valuing collegiality, co-operation and collaboration, as well as effective working relationships, etc. Unlike codes of ethics, values declarations are used to announce the core values, but they usually do not provide detailed rules on how to adopt these values in practical situations. For example, values declarations generally state that transparency is a core value, but do not provide guidelines on, for example, how openly public servants can behave towards the public on matters that are still under preparation. These kinds of guidelines or detailed standards of behaviour can be found in a code of conduct – which is often an extended value declaration that transforms the values into practice (Moilanen and Salminen, 2006).

Box 4.9. **Definitions of terms relating to ethics in the public service**

Values: The individual principles or standards that guide judgment about what is good and proper.

Conduct: The actual actions and behaviour of public servants.

Ethos: The sum of ideals which define an overall culture in the public service.

Ethics: The rules that translate characteristic ideals or ethos into every-day practice.

Source: OECD (1996), "Ethics in the Public Service: Current Issues and Practice", *Public Management Occasional Papers*, No. 14, OECD, Paris.

Many countries have introduced values declarations or codes of ethics in their public administrations. While these are not mutually exclusive, they can be used simultaneously. Codes of ethics usually include core values, thus eliminating the need for a separate values declaration (Moilanen and Salminen, 2006). Values declarations and codes of conduct can be seen as two steps in the development of official ethics. As a first step, countries often begin by identifying their core values and promote them by announcing a declaration of values. After this, as the discussion on public service ethics advances, the state is ready to introduce more systematic and detailed guidelines in the form of a code of ethics. However, there is no clear-cut difference between a values declaration and code of ethics. Rather, it should be considered as a continuum from values to standards (Moilanen and Salminen, 2006). Values declarations and codes of ethics can be used at many levels: there may be a general code of ethics, branch-specific codes of ethics and agency-specific codes of ethics, which are all in operation at the same time (Moilanen and Salminen, 2006).

Public service values tend to be enshrined in public service legislation or constitutions, supported by codes of conduct, and protected by administrative procedures and sanctions. The Estonian public administration operates a code of ethical values defined in an appendix to the *Public Service Act* (see Box 4.10). Under of the *Public Service Act* (Section 59), public servants shall perform their duties pursuant to the Public Service Code of Ethics and other codes of ethics established within their administrative agencies. Thus, while there is

Box 4.10. **Estonian Public Service Code of Ethics**

1. An official is a citizen in the service of people.
2. The activities of an official shall be based on respect for the Constitution of the Republic of Estonia provided for in the oath of office.
3. An official shall adhere, in his or her activities, to the legally expressed will of politicians who have received a mandate from the citizens.
4. Public authority shall be exercised solely in the public interest.
5. Public authority shall always be exercised pursuant to law.
6. The exercise of public authority shall always involve liability.
7. The exercise of public authority is, as a rule, a public activity.
8. An official shall be prepared to make unpopular decisions in the public interest.
9. A person exercising public authority shall endeavour to achieve as broad participation of citizens in the exercise of authority as possible.
10. An official shall always, in his or her activities, subject departmental interests to public interest.
11. An official shall be politically impartial in his or her activities.
12. An official shall make decisions based on public and generally understandable criteria.
13. An official shall avoid creating a situation which arouses or may arouse suspicion with regard to his or her impartiality or objectivity in considering matters under suspicion.
14. An official shall treat property entrusted to him or her economically, expediently and prudently.
15. An official shall use information which becomes known to him or her through official duties solely in the public interest.
16. A person exercising public authority is characterised by honesty and respect for the public and co-employees.
17. An official shall be polite and helpful when communicating with people.
18. An official shall be respectable, responsible and conscientious.
19. An official shall do his or her best in the public service by constant individual development.
20. An official shall facilitate the spread of the above principles in every way.

Source: Republic of Estonia (1996), *Public Service Act*, Tallinn.

a very broad set of public sector ethical values prescribed by law, individual public sector organisations are also free to develop their own value statements.

In decentralised public administration systems like that operating in Estonia, public service values can help to embed a culture where all actors in the administration are working towards the same goals. Even in decentralised public administrations, governments typically still want to maintain a set of shared values and common structures and processes, which are generally managed from the Centre. Working in a whole-of-government way does not mean a "group-think approach". The creation of a single public service identity can only be achieved if public service values are aligned across organisations. The application of diverse perspectives on particular issues is an important element of providing good policy advice to government. Skills in creative resolution of conflicting objectives, a willingness and ability to

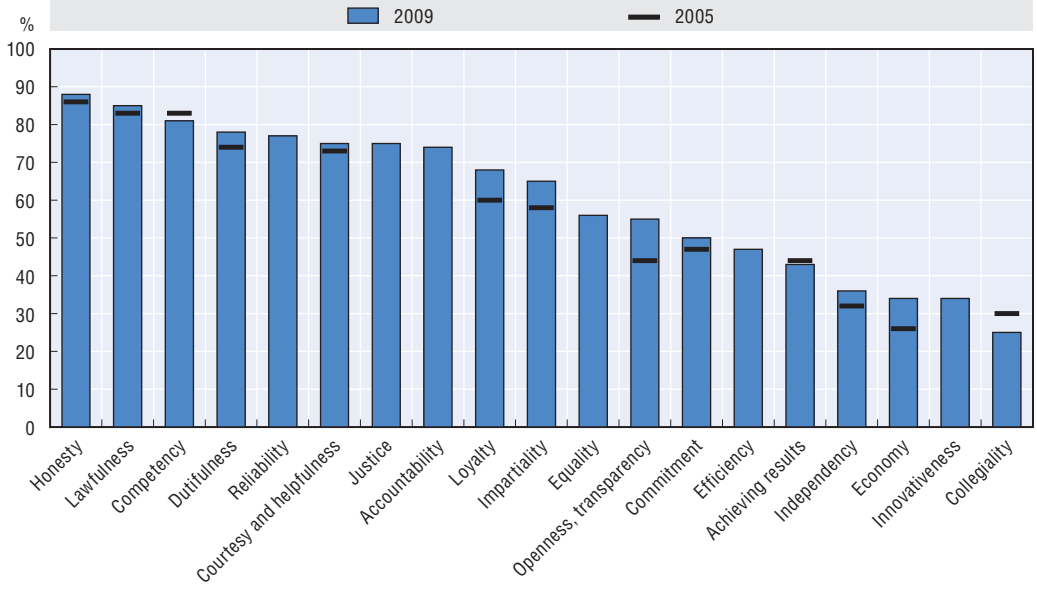
understand the big picture, and an ethical commitment to fair and open dealings between departments are all critical to good whole-of-government work.

As discussed earlier, Estonia's governance system and its public administration depend on informal and personal networks. In an environment of informality, a shared set of values is particularly important for shaping behaviour. Within networks, common values – as well as common problem definitions – are crucial for collaboration among partners. Likewise, the standardisation of norms and values is an important means for intra-organisational co-ordination. In that perspective, a common political or corporate culture that may exist among a set of actors may produce co-ordination with minimal formal interaction (Bouckaert, G., B.G. Peters and K. Verhoest, 2010).

While the use of informal networks as a mechanism for collaboration and co-operation is high in Estonia, a *Survey of Roles and Attitudes in Estonian Public Service* found that only 25% of staff surveyed considered the value of "collegiality" as "very important" (down from 30% in 2005). Interestingly, the percentage of staff surveyed that valued "independence" as "very important" increased to 36% in 2009, up from 32% in 2005 (Government Office, 2009) (see Figure 4.3). The top three values considered most important by public sector staff included honesty, lawfulness and competency. This is similar to values in other OECD countries, which all have remarkably similar stated values despite differences in social, political and administrative contexts. Impartiality and legality have remained the top public service values over the past decade in OECD member countries (OECD, 2009f).

Figure 4.3. **Values in Estonian public service, 2005 and 2009**

Percentage of respondents who considered the respective value as very important



Values of reliability, justice, accountability, equality, efficiency and innovativeness were not surveyed in 2005.
N = 960 respondents in 2005 and 1 032 respondents in 2009.

Source: Government Office (2009), *The Roles and Attitudes of the Public Service*, Republic of Estonia, Tallinn (available only in Estonian).

When asked what values distinguish public service from other sectors, only 6% considered co-operation (see Table 4.2). These results highlight the importance of regularly reinforcing values of collaboration and co-operation as fundamental principles for

Table 4.2. **What values and attitudes distinguish public service from other sectors?**

Percentage of respondents who identified respective values and attitudes

Values	%
Conscientiousness, sense of duty	17
Loyalty to country, faith in the country, loyalty, lawfulness	16
Respect for human beings, desire to serve the public, empathy	16
Honesty, integrity	16
Apolitical, impartiality, objectivity, independence	14
Working in the public interest	11
Competence, professionalism, expertise	7
Dedication, sense of mission	7
Co-operation	6
Integrity, dignity, following the Code of Ethics	6
Accuracy, precision	5
Openness, transparency	4
Broad mindedness, interest in self development	3
Consistent, persistent, principled	3
Effectiveness, efficiency, results orientation, concreteness	3
Helpfulness, civility, obligingness	3
Communication skills	2
Courtesy, discipline	2
Innovation, development orientation, openness to change	1
Diligence, willingness and ability to work hard	1
Seeing the whole picture, strategic thinking	1
Initiative	1
Other	3
Do not know	33

N = 960 respondents in 2005 and 1 032 respondents in 2009.
Source: Government Office (2009), *The Roles and Attitudes of the Public Service*, Republic of Estonia, Tallinn (available only in Estonian).

working. In order for the Estonian public administration to work in a more collegiate and joined-up/whole-of-government manner the values of co-operation and collegiality need to be given more importance. When asked what they thought the obstacles were to improving public service ethics, respondents expressed their opinion towards different issues such as the general level of ethics in society, organisational culture, cronyism, and agency working arrangements, among others (see Table 4.3).

In examining the results of the *Survey of Roles and Attitudes in Estonian Public Service*, which focused on factors affecting ethical behaviour, those necessary to sustain an organisational culture supportive of a whole-of-government way of working (*e.g.* collegiality) were not highly rated (see Box 4.10). For the public administration to be able to work in such a way, priority needs to be placed on such values. Estonia could begin by reviewing its existing code of ethics and incorporating values which support a culture of working in a whole-of-government manner. Values which focus on collegiality, collaboration, co-operation, relationship management, innovation, and strategic thinking can help to re-focus the attention of Estonian public servants from values of independency. In line with this, the features of developing a whole-of-government culture based on a shared set of values include (Management Advisory Committee, 2004):

- readiness to think and act across ministry/agency boundaries;
- effective teamwork;

Table 4.3. **Obstacles to improving public sector ethics in Estonia, 2005 and 2009**

Percentage of respondents who considered the respective aspect a "very important" and "important" obstacle

	2005	2009
General level of ethics in society	79	48
Payroll system would be unfair or unclear	74	47
Unclear promotion principles	71	45
Politicisation of parts of the administration	66	44
Self-centeredness in decision making	63	42
Laws and regulations interpreted in different ways	68	42
Hierarchical relationships	49	37
Unclear criteria for recruiting civil servants	63	37
Lack of clear and unambiguous ethical standards in public service	59	36
Organisational culture (the unwritten practices, the climate of the organisation)	67	35
Staff turnover	71	34
Cronyism	51	31
Organisation's working arrangements	57	18

N = 960 respondents in 2005 and 1 032 respondents in 2009.
Source: Government Office (2009), *The Roles and Attitudes of the Public Service*, Republic of Estonia, Tallinn (available only in Estonian).

- organisational flexibility;
- openness to innovation and creativity;
- the ability to capitalise on windows of opportunity, tolerate mistakes and manage risk;
- the capacity to build strategic alliances, collaboration and trust;
- adaptability to changing circumstances;
- persistence;
- encouragement of the expression of diverse views, and awareness of different cultures and appreciation of their strengths;
- a capacity to balance the tension between short-term goals; and
- effective knowledge management.

Having a set of public service values which supports working in a whole-of-government manner alone is not sufficient to ensure that public servants will actually work in such a way. There needs to be a shared understanding and practice of the values which support such a culture. An effective way to foster a public administration that operates in a whole-of-government manner is to integrate public service values with management systems. In fact, this was highlighted by staff as an action that would help to make the Estonian public administration more ethical (see Table 4.4).

Embedding a set of values into the culture of the public administration which supports a whole-of-government way of working requires integrating those values into human resource management frameworks, such as recruitment and selection, learning and development, performance management, and pay and benefits. For example, a common set of values should underline selection criteria for staff recruitment, as well as assessment criteria for individual staff performance management. In addition to providing training specifically focused on the implementation of codes of ethics and public service values, other training courses provided in the workplace should also support the development of competencies linked to the common set of values (such as promoting values of

Table 4.4. **Measures to reinforce public service ethics in Estonia, 2005 and 2009**
Percentage of respondents who considered the respective measure "very Important"

	2005	2009
Leader's personal example of excellence	62	60
Improvement in the political culture	53	47
A clearer human resources (HR) policy (principle and policies for recruitment, hiring, appraisal, promotion and remuneration of civil servants)	38	28
Improved administrative culture	42	28
Trainings on ethics among public servants	21	22
Mainstreaming and explaining public ethics in society	31	21
Instructional materials, standardised codes of ethics	20	20
Organisational internal code of ethics	15	18
Stronger public supervision of compliance of ethics in the public service	21	17
Clarification or revision of job descriptions	17	16
Stronger organisational supervision of compliance of ethics	22	15
Higher wages	38	13
Independent committee /council of public service ethics (forming opinions and advice as requiring an assessment of ethical issues)	10	10
Tightening regulatory restrictions	9	8

N = 960 respondents in 2005 and 1 032 respondents in 2009.
Source: Government Office (2009), *The Roles and Attitudes of the Public Service*, Republic of Estonia, Tallinn (available only in Estonian).

co-operation, collegiality, etc.). Leadership programmes are also a good way to foster public service values, with senior management demonstrating the practical application of the values by "leading by example". To this end, a shared whole-of-government set of values should be linked to the training provided as part of the Estonian Senior Leadership Competency Programme.

Communication of public service values also will be critical to the successful embedding of the values into the culture of the Estonian public administration. For example, the Public Administration and Public Service Department in the Ministry of Finance could undertake a communications campaign to raise awareness of the code of ethics and develop mechanisms for embedding the principles of the code into organisational culture across the whole of the public administration and at all levels of government. Estonia could look to countries such as Australia, Canada, New Zealand, Switzerland and the United Kingdom for examples on how to integrate public service ethics as part of organisational culture.

Introducing accountability and incentives

Supporting a whole-of-government culture requires not only systematic attention to developing, communicating, and embedding a set of supportive public service values, but also to an underlying incentive structure. Thus, in addition to the use of public service values, a whole-of-government culture can also be fostered and reinforced through the use of individual staff performance management systems. Linking the achievement of organisational and whole-of-government objectives and outcomes to individual staff performance provides a valuable mechanism for aligning organisational and individual behaviour and incentives. In addition, using public service values (as discussed in the previous section) to provide the foundation on which to base individual staff performance management and assessment can help to strengthen the development of a whole-of-government ethos in the public administration.

Performance management is a key tool for measuring the efficiency and effectiveness of public sector operations, as well as accountability of actions. It should operate at the whole-of-government level and within individual public sector organisations to ensure that the government's agenda is clearly translated into a work programme with measureable outcomes for each ministry and agency. Performance management systems can also be used to ensure that staff behave and operate in a manner that supports a core set of public service values which define what the public service stands for and how it wishes to operate. At the most basic level, performance management starts with the assessment of individual staff performance. Individual performance assessment is a critical part of a broader performance management system (see Chapter 5: "Building a Common Agenda").

To be effective, performance management systems should link the management of people to institutional goals and strategies. The success of a performance management system depends on three components: *a)* the linkage of the overall performance management system to strategic planning and budget allocation at the whole-of-government and organisational levels; *b)* goals and strategies that are clearly defined and communicated to employees; and *c)* managers who can objectively assess and measure performance, and use this information appropriately. Individual performance assessments or appraisals form an integral part of this system (OECD, 2010f) (see Box 4.11).

Box 4.11. **What is performance management?**

Performance management addresses efficiency and effectiveness of operations, but also accountability of actions. Performance management is made up of four levels:

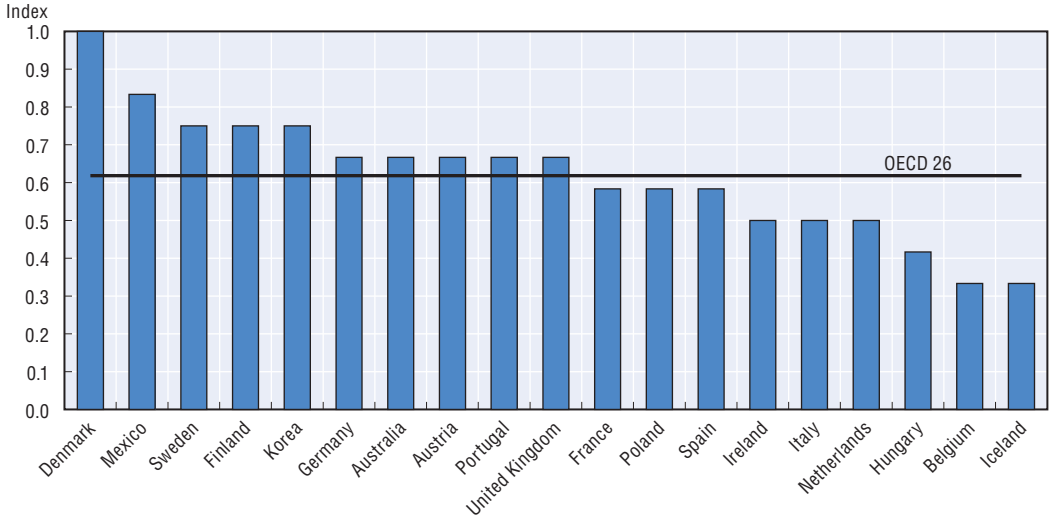
- At the *highest* level, performance management is rooted in the organisation's long-term vision and business strategy and focused on impact, resource utilisation and public service improvement.
- At the *strategic* level, performance management is focused on outcomes, such as volume and value of service take-up, upward trends for inclusion, and staff and user satisfaction.
- At the *programme* level, performance management is focused on the desired output of programmes, and on what has been accomplished.
- At the *operational service* level, performance management is concerned with process quality, service delivery and outputs, but also with the individuals or teams of individuals who are expected to deliver these results.

Source: OECD (2008), *The State of the Public Service*, OECD, Paris.

Of the OECD countries for which there is comparable data, there is a large spectrum between those that use performance assessment to a high degree and those that do not use it at all (see Figure 4.4). Those countries ranked highly use performance assessment in career advancement, remuneration, and contract renewal decisions (index developed based on 1 = high use and 0 = no use on a percentage input of 25%, 25% and 50% respectively).

The Estonian public administration only makes sporadic use of individual staff performance management. Data provided by the Ministry of Finance indicates that the number of annual staff performance interviews has been decreasing in the Estonian public service since 2005 (data is not available before this) (see Figure 4.5). The largest decrease in the number of individual staff performance assessment interviews undertaken was in the

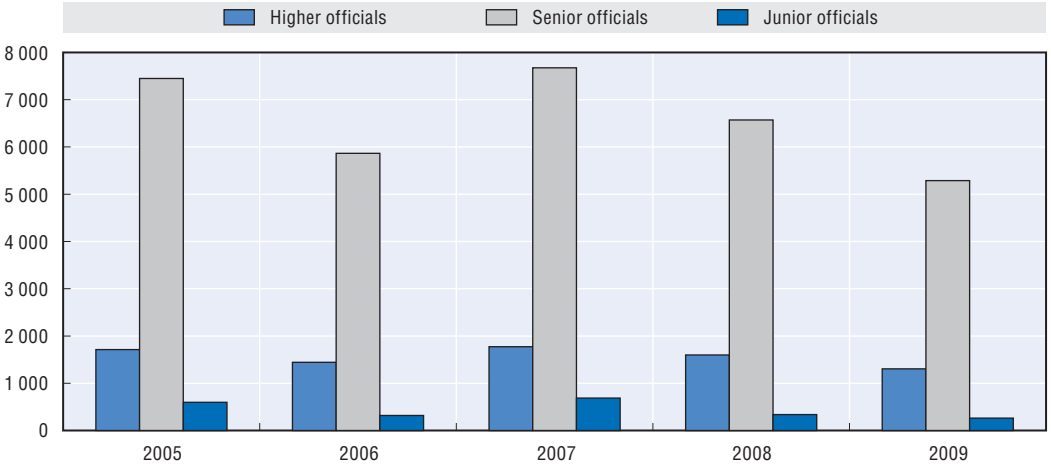
Figure 4.4. **Extent of the use of performance assessments in HR decisions in central government, 2005**



Note: Data refer to 2005 and were collected through the 2006 *OECD Strategic Human Resource Management in Government Survey*. Countries missing from the figure are those for which the OECD had incomplete or inconsistent data at the time of collection. Data for Estonia was not collected as part of this survey and is therefore not available for comparative purposes.

Source: OECD (2009), *Government at a Glance*, OECD, Paris.

Figure 4.5. **Number of annual performance assessment interviews conducted, 2005-09**



Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

staffing category of "junior official", which had a percentage decrease of 55.9% between 2005 and 2009, compared to 29% for senior officials and 23.7% for higher officials for the same period. In 2008-09, the institutions with the largest decrease in interviews were ministries: 32.9%, compared to a 14.9% decrease in governing areas of ministries (Ministry of Finance, 2010a). The number of staff interviewed as a percentage of all staff has also decreased significantly from 41% in 2005 to 29% in 2009. The Ministry of Finance reports that the decrease in the number of assessment interviews can be explained by a smaller number of recruitments and extensive structural changes, which have resulted in changes to

immediate supervisors, or due to the recent commencement of an official (who is not required to undergo an interview for the first six months) (Ministry of Finance, 2010a).[3] Despite the reasons, the dramatic decrease in the number of individual staff performance assessment interviews undertaken is significant. Estonia should give urgent attention to this trend and look to undertake a comprehensive renewal programme to establish the use of individual staff performance assessments as a fundamental tool for managing performance and for supporting a whole-of-government culture.

Performance assessment implies a methodology and set of procedures for rating the work performance of individuals according to standards and criteria applied across one or several organisations in a similar fashion. In Estonia, the individual staff performance assessment system, as outlined in the *Public Service Act*, has not changed during the last 10 years (Ministry of Finance, 2010a). According to the *Public Service Act*, upon completion of the probationary period, at least one assessment interview is expected per year between an official and his/her immediate supervisor. All public servants are to be evaluated once every three years, or before presented for promotion to a senior position by a competition and evaluation committee (Republic of Estonia, 1996a). As stipulated in the *Public Service Act*, the assessment or evaluation of a staff member is made by the immediate supervisor who evaluates the suitability of the person for the position by assessing his/her work results and whether s/he meets the requirements set for the position. As the guidelines and procedures for individual staff assessments prescribed in the *Public Service Act* is rather overregulated, the process has turned out to be quite formal in practice. Furthermore, since the attempts to amend the *Public Service Act* have failed and there is no institution which has the mandate to sanction those organisations and officials who have not followed the procedure, the organisations are not motivated to implement the assessments.

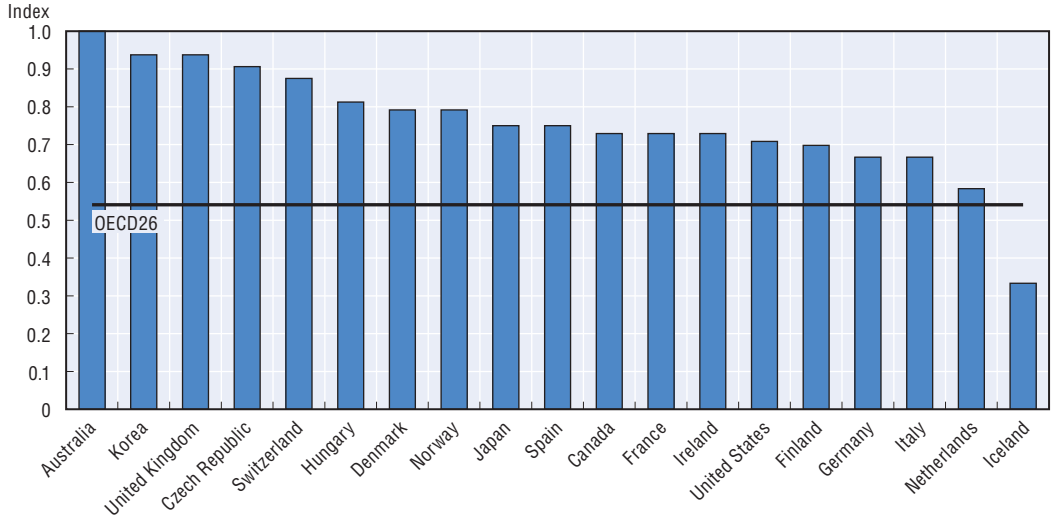
In the absence of a formal, well functioning individual staff performance assessment system, many innovative and more effective performance appraisal models have been developed during recent years. Many organisations have developed competency models for recruitment appraisal and development of their staff *(e.g.,* National Audit Office, Ministry of Environment, Ministry of Foreign Affairs, and Ministry of Social Affairs). These frameworks are mainly enforced by organisational regulations. In the absence of a common methodology for individual staff performance assessment there is opportunity for the innovative models developed in some organisations to be shared as best practice across the public service.

Robust performance management practices can help to overcome the influence of any one individual in a system and to focus individuals in the same direction to achieve shared goals. Estonia has been piloting a competency framework for its senior public service. Commencing in 2005, the Competency Framework of the Estonian Civil Service was developed as a tool to support the selection and development of senior executives to ensure the achievement of the state's strategic objectives. The programme targets a group of 88 senior managers, including Secretaries General and Deputy Secretaries General of ministries, Directors General of Boards and Inspectorates and County Governors. The programme includes an evaluation of competencies, which is conducted annually, based on five key areas: credibility, having a vision, innovation, leadership and outcome orientation.[4] At this stage, evaluations are for learning and development purposes only and are not linked to formal individual staff performance evaluations.

Many OECD countries use individual performance pay as a mechanism for creating stronger personal incentives to link individual outputs to the collective achievement of government outcomes. Of the 26 OECD countries for which there are comparable data, about two-thirds have some form of performance-related pay (about one-third do not use performance-related pay) (see Figure 4.6). There is no single model of performance-related pay among countries. However, a trend is that performance-related pay has spread from the management level to cover other categories of staff. Several countries in the middle in terms of using performance-related pay – such as Canada, Ireland or Italy – only include senior managers. In the Netherlands, only some government organisations use performance-related pay. None of these indexes measure the capacity of the HRM system to motivate employees or the performance of employees. Further, many countries manage to nurture a performance culture without a formalised performance focus, and some are implementing performance-based policies (such as performance-related pay) more informally.

Figure 4.6. **Extent of the use of performance-related pay in central government, 2005**

Index comprised between 0 (no PRP) and 1 (high PRP level)



Note: Data refer to 2005 and were collected through the 2006 *OECD Strategic Human Resource Management in Government Survey*. Countries missing from the figure are those for which the OECD had incomplete or inconsistent data at the time of collection. Data for Estonia was not collected as part of this survey and is therefore not available for comparative purposes.

Source: OECD (2009), *Government at a Glance*, OECD, Paris.

Estonia does operate a performance pay scheme, where individual performance pay forms part of the existing salary system. However, as a result of the global economic and financial crisis, performance pay for staff was suspended as part of austerity measures used to reduce public sector outlays. It is unclear at this point what effect this has had on the motivation of staff working in the public administration.

In order to align the government's objectives with organisational and individual incentives, as well as with a shared achievement of government outcomes, effective individual performance management systems must be used and linked to broader performance budgeting and strategic planning frameworks. From the interviews undertaken by the OECD, it is understood that where they do occur, individual staff performance

assessment interviews only include discussions and planning for a staff member's immediate responsibilities without regard for links to an organisation-wide or whole-of-service competency framework or work plan. Although the interviews undertaken by the OECD showed that evaluation of staff takes place directly against a position description, which in Estonia is prepared specifically for the individual and his/her position, there are some organisations that have developed their organisation-specific competency models. These assessments are not linked to a broader competency criteria for the level or type of work undertaken. In addition, the interview is primarily an evaluation of a staff member's performance, and is not linked to more positive incentives such as assessing skills and experience gaps as a means for establishing individual learning and development plans as part of a continual learning programme.

At an international seminar held by the Ministry of Finance in Tallinn in 2010, sponsored by the UNDP and attended by public service development experts from 10 European countries, it was noted the main shortcomings of the public service is an insufficient connection between strategic objectives of the state, the organisations and personal work performance of public servants (Ministry of Finance, 2010a). A performance management system should be a systematic process by which an organisation involves its employees, as individuals and members of a group, in improving organisational effectiveness in the accomplishment of ministry/agency mission goals. Such systems provide a valuable mechanism for aligning organisational and individual incentives with overall government objectives and should include elements for (OECD, 2008g):

- planning work and setting expectations;
- continually monitoring and appraising expectations;
- continually monitoring and appraising performance;
- developing the capacity to perform;
- periodically rating performance in an adapted fashion; and
- rewarding good performance.

Beyond the senior leadership level, individual performance management is not a systemic activity in Estonia's public administration. Some organisations have introduced a level of performance assessment, but these are not linked to any robust standard of accountability for the achievement of results. Larger agencies tend to have more integrated individual performance assessment systems than ministries or small agencies, boards, or inspectorates. The Ministry of Finance is aware of the need to improve performance management in the Estonian public administration and is in the process of developing performance management proposals that are being piloted in the public administration (see Chapter 5: "Building a Common Agenda"). However, at this stage, there is no approved whole-of-public service approach to the implementation of an individual staff performance management system. The Ministry of Finance's efforts, if agreed by Government, would introduce a performance budgeting framework for use as part of budget preparation, negotiations and decision making, thereby providing a government-wide framework through which an individual performance assessment system could operate.

The proposal to implement an individual performance assessment process as part of a broader draft change to the *Public Service Act* is a positive step towards integrating performance assessments into the culture of the Estonian public administration. However, to be effective, a service-wide individual staff performance management system needs to link through to government-wide budget and strategic planning frameworks such as the wider

performance management system reform being proposed by the Ministry of Finance and to the existing strategic planning regulation (see Chapter 5: "Building a Common Agenda"). It should also be embedded into every public sector organisation, and, for real accountability to occur, it must be appropriately and effectively made operational. An individual performance assessment process must form the base level of guidelines and expectations to ensure coherence across the public administration. This can then be adapted to the needs of each organisation. However, some level of central best practice needs to be provided to ensure that line managers and HR units can cope with the tasks devolved to them.

Estonia should implement a coherent individual performance management system across the public administration regardless of staff or official level (while allowing for tailoring within the decentralised system). To achieve this, Estonia could usefully look to countries such as Australia, Canada, Denmark, Finland, Germany and Sweden, which have embedded the use of individual staff performance management systems into the culture of the public administration. An individual staff performance management system for Estonia's public sector may take some time to develop and establish and should be linked to consideration of the implementation of wider performance budgeting reforms (but can be implemented separately).

Building a flexible public administration

Achieving a single government approach requires the public administration to be able to flexibly place its resources where they will best meet the needs of the government. By viewing itself as one entity – rather than many individual silo-ed public sector organisations – Estonia's public administration could achieve greater flexibility in the placement of human resources.

Increasing workforce flexibility through a mobile workforce

In working towards achieving a public administration that works together as a single entity, staff mobility is critical to breaking down silo-ed organisational structures and to broaden the skills, experience and mind-sets of public sector staff. Increased movement of staff enables the sharing of different ways of working and helps to broaden and deepen their skill sets, particularly in the area of strategic thinking and analytical capacity, as well as developing collegiate working relationships. Greater workforce mobility helps to make the public administration more flexible and agile in placing its resources to best meet the needs of government.

Workforce mobility is defined as "the patterns of intra-and inter-organisational transitions over the course of a person's work life" (Ng *et al.*, 2007). For the purpose of OECD Public Governance Reviews, workforce mobility includes internal movement between ministries/agencies at the state level (including lateral and downward movement, acting appointments and promotions); movement between the state administration and the sub-national levels; and movement to the private sector.

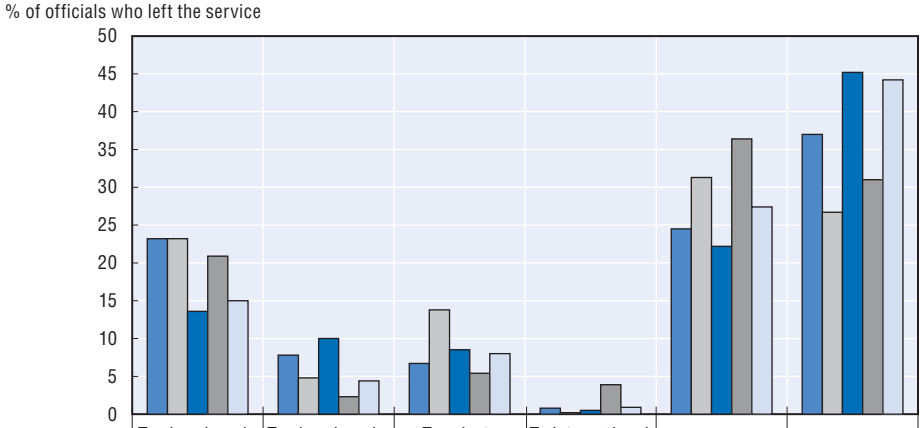
The culture of Estonia's public administration generally works against the movement of staff between public sector organisations. As discussed earlier, organisational culture is critical to achieving change and to working in a more whole-of-government manner. It is difficult to determine the actual level of workforce mobility within Estonia's public administration. There is insufficient data available as to mobility of staff within, nor separate data on mobility between, public sector organisations. Thus, it is not possible with the information available to determine the actual rate/level of staff mobility between public sector organisations. In addition, the data available is somewhat unreliable due to

the large number of unknown reasons for departures. For example, of the 2009 data collected 23.7% of officials left the organisation for "other" reasons and for 35.6% there was no data available (Ministry of Finance, 2010a).

The data that is available shows that in 2009, 2 285 officials left the state public administration for various reasons (10.6% of all officials in the service in 2008) and 1 651 officials entered the public administration (7.7% of all officials in the service in 2008) (Ministry of Finance, 2010a). The Ministry of Finance reports that in 2009,[5] 2 202 officials moved to different positions within their organisation (9.1% of all officials in the service in 2008); that at least 23.2% of officials who left their posts acquired new posts in the public service[6] (up 0.3% from 2008); and that at least 6.7% acquired new positions in the private sector (down from 14% in 2008 and 23.4% in 2007) (Ministry of Finance, 2010a). This is the critical statistic when examining workforce mobility for the purposes of increasing mobility across organisations and portfolios.

In 2009, 886 officials (38.8%) left the public service for involuntary reasons, including the expiry of their term of service, winding-up of an administrative agency or dismissal (up from 10.3% [or 883 officials] in 2008) (Ministry of Finance, 2010a). Total turnover of officials was the highest in ministries where 20.4% of officials left in 2009. Total turnover was most stable in executive agencies and inspectorates, where 8.5% of officials left the service and 7.8% of officials entered into service (Ministry of Finance, 2010a). Of those staff that left the public administration in 2009, 23.2% moved within the public service (0.3% more than in 2008); 6.7% moved to private sector positions (compared to 14% in 2008 and 23.4% in 2007); and 0.8% acquired a new position in the European Union or other international organisation (Ministry of Finance, 2010a) (see Figure 4.7). Voluntary turnover,[7] which was initiated at the choice of the official was 6.7% in 2009.

Figure 4.7. **Distribution of public servants who left the service, according to their new position, 2009**



	To elsewhere in public service	To elsewhere in public sector	To private sector	To international organisations	Other	No information
Total of stae administrative agencies	23.2%	7.8%	6.7%	0.8%	24.5%	37.0%
Ministries with their subordinate agencies	23.2%	4.8%	13.8%	0.2%	31.3%	26.7%
Subordinate agencies of ministries	13.6%	10.0%	8.5%	0.5%	22.2%	45.2%
Constitutional institutions with subordinate agencies	20.9%	2.3%	5.4%	3.9%	36.4%	31.0%
County governments	15.0%	4.4%	8.0%	0.9%	27.4%	44.2%

Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

The data captured on mobility in Estonia's public administration is not detailed enough to make an assessment as to the actual level of workforce mobility. Few OECD countries keep a record of full mobility data. Mobility between departments and between ministries remains low in many OECD countries, between 0.15% and 2.5% of staff per year for the countries which have provided data (see Table 4.5).

Table 4.5. **Proportion of employees who moved between departments/ministries**

	%
Norway[1]	2.5
Portugal	2.2
Australia[2]	2.0
Netherlands	1-2.0
Finland[3]	1.8
Italy[4]	1.3
Sweden[5]	1.0
Korea[6]	0.2

1. Between 2004 and 2005.
2. Between 2004 and 2005.
3. 2004.
4. Estimate; from 1992 to 2002: 9 515 (13%).
5. Estimate; around 8-10% moved between departments/ministries between 1995 and 2003 (calculated on those who stayed in the sector) while the last two years show a somewhat lower mobility, 6.1%.
6. Estimate; from 2001 to 2005: 0.80%.

Source: OECD (2008) unpublished data, *The State of the Public Service*, OECD, Paris; OECD (2006), *Survey results: OECD Strategic Human Resource Management Survey*.

Estonia could benefit from implementing a central data collection repository for tracking HR statistics to increase the reliability of its data collection and expand the type of information collected. In this instance, procedures for exit interviews or use of departure data collection forms should be examined to better capture reasons for staff departures. This information could be collected by expanding the HR component of the Shared Support Services project.

Increasing the ability to move staff within the public administration helps to ensure that the public administration is best placed to meet the needs of government. In order to adapt to the changing and increasingly complex policy environment, public administrations need the flexibility to place their resources where they can best meet the needs of the government. In being responsive to government, the public administration needs to be able to place the right resources in the right place and at the right time to deliver on the government's needs. While it is critical to be able to divert financial resources in times of crisis or as priorities change, it is similarly essential that the public administration has the flexibility to move its human resources.

A culture of a more united and mobile workforce contributes to achieving greater flexibility of the public sector's human resources. A mobile culture also makes it easier to temporarily take staff from various ministries and agencies to work as part of a taskforce to develop a strategic policy or take a strategic policy initiative and prepare it for implementation. Such a "SWAT team" concept is also very useful to deploy in times of crisis or great need. Rather than creating rigid policy units that move between departments depending on the issue, a more flexible option is to use taskforces to address complex or urgent developments in policy or service delivery that cut across many parts of government, or to manage

significant one-off projects or events. As the central body responsible for the co-ordination of policy, the Government Office is in a unique position to be able to convene a taskforce by drawing in expert staff from relevant ministries, agencies or institutional bodies to temporarily work on an issue. Taskforces could also be established by lead ministries, where expert staff from other ministries/agencies/organisations are temporarily re-assigned to participate. Taskforces should only be utilised for a short period of time and the work handed over to a responsible Ministry for implementation and long-term maintenance. This way of working should be supported and balanced by introducing greater co-ordination and conditions for mobility and stronger employer branding for the public administration.

While increased mobility helps to foster increased workforce flexibility, greater collegiality, co-operation and collaboration, and helps staff to develop deeper and broader skill sets, it must be appropriately managed so as to not create instability and loss of corporate knowledge resulting in an inability to be responsive to the government. Thus, the desire for increased workforce flexibility and the benefits it provides must be finely managed and balanced against the issues that it can create (see also discussion of knowledge management earlier in this chapter and in Chapter 5: "Building a Common Agenda").

The Estonian public administration is aware of the need to increase staff mobility across ministries/agencies. A draft bill proposing to modernise the *Public Service Act*, which recently stalled in and subsequently dropped out of the Parliament upon the expiration of its term in March 2011, included a proposal to introduce a staff rotation scheme as a means of increasing the movement of staff within and across public service entities. Under the proposed rotation scheme, officials employed in state administrative agencies would be placed in a position in another state administrative agency for 18 months as a means of broadening their skills and experience. After 18 months, these staff would then return to their "home" office within the state administration.

The use of rotations to increase employee skills and experience is a positive move. However, the Estonian proposal could be improved to enhance its effectiveness. First, rotation of staff infers moving staff from one position to another, without going back to their original post. The legislative proposal resembles more of a secondment programme, where staff are temporarily re-assigned for a period of time and then return to their original post. To be effective, job rotation programmes – the systematic movement of an employee from one position to another – should be considered in the broader context of the public administration's HR policies and the broader vision for the public administration. Decisions need to be made before implementing such a programme regarding what impact or effect is to be expected from such a programme. In Estonia, rotation is being put forward as a means to broaden skills and experience, but it can also be used to set an example for increasing mobility across the public administration, as a means of helping to achieve a shared commitment and to change organisational culture.

Estonia is encouraged to implement a system of staff rotation and secondments that is accessible to all levels across the public administration. To maximise the benefits of a job rotation programme, Estonia may need to revisit the design of its original proposal. If Estonia is concerned about implementing a staff rotation system, it could phase the introduction by first implementing a secondment scheme, and then after three to five years, expand this to a rotation scheme. Second, the concept of staff being able to move from their original posting should be opened up beyond the senior leadership group to other staff. Third, to maximise the benefit of rotation, but also reduce susceptibility to frequent movements creating

instability, post periods should be longer – around three to five years (for example, in Australia senior leaders are generally rotated to new positions every five years).

Job rotation programmes also need to align to organisational culture. Job rotation is a good way to re-invigorate the senior leadership of the public administration as it allows them to experience something new. Rotations also help remove "glass ceilings" that arise as the public sector workforce ages and blockages/bottle necks develop where younger staff are not able to access senior management positions. More movement in the workforce (as long as there are guidelines which prevent erroneous movements or too much flexibility, which can create instability) can have a positive impact on organisational culture.

Increasing mobility within the public administration and use of secondments and rotation schemes helps to change the culture of the public administration to be more outward thinking beyond the boundaries of their own ministry, agency or institution to think of themselves more as a public servant, rather than an official of a specific ministry. The single identity concept is important to gaining collective commitment across the public administration.

Working towards a shared vision of the public administration

Achieving an integrated public administration that operates as one entity requires that all parts of the public administration operate as one whole. This means that all of the separate parts of the public administration need to work together towards the achievement of a common agenda. As such, it is essential that the public administration have a coherent and shared vision for the management and use of the administration's human resources. This is particularly critical in small states such as Estonia, and when operating a decentralised and fragmented human resource management system.

Estonia's public administration operates a fragmented and decentralised HR system (see Box 4.12) with no strategic whole-of-administration vision for the role of the public administration and for the management of its personnel. While the Ministry of Finance has responsibility for the overall co-ordination of HR within the public administration, to

Box 4.12. **Estonia's HR system**

HR is decentralised in ministries, with responsibility devolved to individual ministers (within the general framework set by the *Public Service Act*). As such, each ministry is responsible for the HR arrangements within its organisation (directly accountable to each individual minister) – *i.e.*, recruitment, training and development, individual staff performance assessments.

The Ministry of Finance is responsible for overall co-ordination of HR and the provision of horizontal whole-of service training and development; and the Government Office is responsible for senior leadership development (middle management leadership is the responsibility of individual ministries).

The Ministry of Justice has responsibility for public administration law (including responsibility for drafting and maintenance of the *Public Service Act*).

Responsibility for the development of regional and local administrations rests with the Ministry of Interior.

Source: Information adapted from the Ministry of Finance, Estonia, available at: *www.avalikteenistus.ee/index.php?id=10912*.

date this has not included a role for developing and executing a strategic vision for the shape and direction of the public administration and long-term management of the public administration's human resources. In the absence of an explicit requirement or guideline identifying the need for a strategic HR vision in the public administration, responsibility for developing and managing such a vision does not rest with any one minister and/or ministry, and is therefore absent. Silo ministries operate independently with very little co-ordination or collaboration on HR issues, with the exception of the use of training and development, and personnel managers' networks which focus on knowledge sharing rather than developing a joined-up approach to the management of the whole-of-the administration's staff.

The lack of vision for Estonia's public administration is a long-standing issue that was initially raised in 1996 by the Public Administration Development Committee (established in August 1995), which was responsible for planning the practical implementation of the *Government of the Republic Act*, which, along with the Constitution of the Republic of Estonia and the Rules of the Government of the Republic, set the responsibilities and procedures of the government. In analysing the work arrangements and functions of the public administration model during the Spring of 1996, the Committee noted that neither the *Government of the Republic Act* nor the *Public Service Act* have solved the issue of the absence of a government agency which leads and co-ordinates the development of the public administration – this is the reason why the conceptual basis of previous reforms have been inadequate.[8]

In June 1997, the government established an Administrative Reform Expert Committee to develop a uniform concept for administration reform, including suggestions for solving the conceptual and implementation issues of the public service. This work informed various attempts to modernise Estonia's *Public Service Act* (which took effect on 1 January 1996) from 1999 to the present. A long and protracted process has ensued, with all attempts to amend the existing Act failing – either due to withdrawal of support or non-approval by the Government, or due to passage being thwarted in the Parliament. A further attempt to reform the existing *Public Service Act* was before the Parliament again in 2010, but this was not successful. It again proved to be a missed opportunity to develop a strategic vision for the public administration.

As a small transition country, over the last 15 to 20 years Estonia has concentrated on rapidly building the capacity of the public administration. The focus has been short-term and reactive in order to meet the needs of the day. Now that Estonia has an established public administration, it is critical for it to develop a strategic vision for the type of employer it wants to be in the long-term, as well as how it will achieve a flexible and efficient public administration by maximising the use of its human resources in the short to medium-term. This is of particular importance given the small labour market, and upcoming demographic changes.

Such a strategic vision does not currently exist for Estonia's public administration, despite the Ministry of Finance's responsibility for overall HR co-ordination within the public administration. Such activity may develop over time, as these responsibilities were only recently consolidated into the Ministry of Finance. In order to achieve greater co-ordination within the public administration towards the achievement of a shared whole-of-service vision for the management of the administration, the Public Service and Public

Administration Department within the Ministry of Finance should be strengthened and given authority to take on such a role.

In some OECD countries, Civil Service Commissions, which are independent bodies, have responsibility and authority to observe and support human resources arrangements in devolved and decentralised public administrations. While a separate Civil Service Commission is not the only model for strengthening a more strategic and whole-of-service approach to HR, the evolving role of the Public Service and Public Administration Department in the Ministry of Finance could be modelled on such a concept.

Devolving HR responsibilities and establishing a more flexible employment framework

In order for the public administration to fulfil its strategic vision and flexibly respond to government needs efficiently and effectively, managers need to be able to actually manage their human resources; that is, to have the authority to recruit, place, and move staff as necessary, both within and across public sector organisations. This is critically important for achieving both greater flexibility in the use of the public sector's resources and a more unified service.

Under existing arrangements, responsibility for human resource appointments is shared between Ministers and Secretaries General. Section 49 of the *Government of the Republic Act* notes that a minister, as head of a corresponding ministry, shall on the proposal of the Secretary General of the ministry, appoint to and release from office, ministry staff down to the level of Head of Department. While these decisions are made based on a proposal by the Secretary General, the Minister is the approving authority. The Secretary General of each ministry has the explicit responsibility to appoint and release staff at all levels below and including Head of Division/Bureau/Section (see Figure 4.8). In practice, the respective roles and responsibilities of the minister and Secretary General are different across each ministry due to different application of HR approaches. As such, Secretaries General do not have complete autonomy for the total management of human resources within their organisations and there is not a coherent approach to the roles and responsibilities across the public administration. While this is not currently any cause of concern in and of itself, as the public administration looks to implement measures to support a whole-of-government way of working it may find that it does not have the total autonomy to manage its human resources as a complete entity (rather than as discrete organisations). This will inhibit the public administration's ability to place its human resources to match needs and demand.

While Secretaries General have input to ministerial decision making on recruitment and have direct control over some staff, this does not give them the flexibility to move staff within the public administration as may be needed to implement the government's agenda. This creates a risk for a stagnant public administration that lacks the agility to be responsive to government and to refresh itself as needed. In order to increase the flexibility of the public administration to work as a single entity to operationalise the government's agenda, responsibility for the management of public sector organisations should be officially devolved from ministers to heads of ministries/agencies/inspectorates, etc. (this would require amendment of the *Government of the Republic Act*). Estonia could look at arrangements in Sweden, where the government has transferred many of the employer's responsibilities to this level, or Australia, where the management of the public administration is independent of government.

Figure 4.8. **Administrative structure of an Estonian ministry**

Minister	**Responsible for the policy direction of the ministry**	Appointment by the President on proposal by the Prime Minister
Assistant Minister	Responsible for a certain policy area within a ministry	
Secretary General	Administrative head of a ministry	Appointment and release from office the responsibility of the Minister
Deputy Secretary General	2-6 top managers responsible for a particular policy area in a ministry	
Head of Department	Line manager responsible for managing the main structural units of the ministry	
Head of Division/Bureau/Section	Line manager responsible for managing a sub-unit of a department	Release from office the responsibility of the Secretary General
Other civil servants	*e.g.,* advisers, specialists, experts	

Note: The position of Assistant Minister was included in the 2003 *Government of the Republic Act*. However, the practice of using this position has been varied and as of 2011 there are no Assistant Ministers in place.

Source: Information sourced from Republic of Estonia (1995) *Government of the Republic Act*, Tallinn; *http://avalikteenistus.ee/index.php?id=10899*.

Devolving responsibility for human resources to the public administration would allow the leadership to establish more collaborative working mechanisms to support emerging government priorities. Such a way of working still depends on getting the culture and incentives right, as discussed earlier, but it serves to help insulate HR decision making from the politics of a coalition government, thereby circumventing natural reluctance to share resources across party lines. Senior leadership still need to collaboratively set appropriate administrative structures within ministries and agencies and to agree to move staff within the public administration as needed to best meet the government's agenda. In the absence of a body responsible for the co-ordination of the public administration, achieving such a whole-of-government environment and perspective may require steering by the State's Secretary.

In addition to full devolution of the responsibility for public service staff, managers need the ability to place staff in positions that best meet the needs of government, as and when needed. While this should not be used lightly, there are occasions when the administrative structure of an organisation needs to be changed or moved to another organisation. As per Section 47 of the *Public Service Act*, an official can only be transferred to another position or be given functions beyond the scope of their position with that person's written consent. It is understood this section was only recently introduced in the summer of 2009 to enable changes to be made in response to the movement of the Public Administration Department from the Government Office to the Ministry of Finance. Previously, staff were required to resign and be re-hired. While this clause is now available, the impact of this amendment will only emerge as future opportunities for organisation restructures occur. However, the job descriptions of a public servant can be changed without their consent if the aim, main function(s), required training and salary do not change, and the volume of functions does not increase significantly [Section 59(1)]. The *Public Service Act* should be further amended to better enable the movement of staff.

Ensuring transparency of salary and working conditions

The operation of a decentralised HR system can contribute to increased flexibility of the public administration's workforce by giving responsibility and discretion to individual public sector organisations to develop their own HR structures, frameworks and policies to suit their needs. However, this increased flexibility can create an environment in which there are

differences in the handling of HR practices across ministries and agencies. The impacts of these differences need to be balanced against frameworks for achieving greater flexibility.

In decentralised HR systems, a central co-ordination body needs to monitor development as unwarranted differences in conditions between different parts of the public administration are potential sources of dissatisfaction and inefficiency (OECD, 2008g). Decentralised HR in Estonia has created a situation where there are differences in working conditions and remuneration across the public administration. Presently, state administration salaries are based on a 29-level salary scheme, as prescribed by the salary system regulated in the *Public Service Act* and *State Public Servants Official Titles and Salary Scale Act*. Prescribed salary grades and basis for payment of additional remuneration for performance of supplementary functions or for undertaking or performing more effective work than is required are established by an annual government regulation.[9] While the salary rates for each of the 29 salary components are revised annually, the salary calculation system is complex, not transparent and difficult to work within. For example, staff remuneration is negotiated upon commencing a new position where the salary amount is determined based on a number of components – it is split into: *a)* basic salary (which is based on an amount identified in the government regulation per the specific salary grade) with differentiation; *b)* an additional remuneration provided by law for years of service, academic degree, proficiency in foreign languages; and *c)* an additional remuneration for performance of supplementary functions or more effective work than is required and other benefits. In addition, staff can also receive performance pay. However, performance-related pay is not regulated by the *Public Service Act*, but by each administrative agency, and it is up to the ministry/agency to decide whether and how to implement it within the framework of personnel costs and law. Performance-related pay was suspended as a result of fiscal tightening measures in response to the global financial and economic crisis. As a result, salaries for the same position level vary greatly within and across organisations, and the composition of salaries is not transparent. Given this, there is an urgent need, which is recognised by many within the administration, for Estonia to reform its public service remuneration system to reduce the complexity and increase the transparency of salary calculations.

The Estonians recognise the problems with their existing public service remuneration system and have been working on a proposal to modernise and harmonise public sector remuneration. To date, this proposal has focused on abolishing the scale and differentiation components of the existing salary system and replacing it with a new classification structure. A public servant's salary would consist of a basic salary (at least 70%) and individual bonus pay (up to 30%). The basic salary amount would be the monthly salary rate as per a public servant's particular type of position, and the individual bonus pay component based on knowledge, experience or skills or greater ability compared to the requirements for the position. It was proposed that performance pay would only be received if measureable targets are negotiated before the commencement of a performance cycle.

The individual performance pay component of any future proposals should be linked to the introduction of performance budgeting, which is currently being developed as part of a proposed Performance Management System reform (see Chapter 5: "Building a Common Agenda"). Furthermore, Ministers and State Secretaries, in co-ordination with the Ministry of Finance, should establish a salary guide together with a salary scale for each ministry, Constitutional institution and relevant administrative agency within their jurisdiction or under their management. While each ministry's salary guide and scale

would be established in co-ordination with the Ministry of Finance, it is still the responsibility of the individual minister to set salary rates based on the salary market.

Such a change to the salary system is unlikely to result in harmonising salaries across the public administration. This is because, under a decentralised HR system, individual ministers are responsible for setting salaries within their own portfolio organisations. This gives them discretion to set salary levels as they wish, to attract and retain a skilled workforce. Decentralised pay systems are not generally used to achieve pay harmonisation across public sector entities – rather centralised pay is used to achieve this. Decentralisation is used more to increase flexibility. Increased transparency of pay rates across the public sector can have the impact of increased mobility, with staff seeking employment in those organisations with higher rates of pay. This can lead to an environment where ministries/agencies compete with each other for the "best" staff through salaries and working conditions. As a result, salaries can actually end up over time increasing where ministries/agencies try to "out do" each other when re-negotiating salary schemes. Thus, the benefits of flexibility, mobility and transparency afforded through decentralised responsibility for public service salaries should be weighed against the impacts: potential for increase in public service wages and differences in the treatment of staff across the administration due to differing pay scales. Harmonising salaries, or aligning salary systems, reduces the incentive to move based on pay, but can make it easier for mobility to occur if incentivised by an alternative mechanism – as pay rates and employment frameworks would be similar/the same.

In order to better facilitate a single public service identity and mobility, it may be beneficial to devolve responsibility for public service remuneration to heads of administrative agencies *(e.g.,* ministries/agencies/inspectorates, etc.) rather than ministers. This would mean that heads of ministries and agencies would be responsible for negotiating and setting pay rates within their own organisations. However, before devolving responsibility, it is advised that a salary classification system first be agreed and rolled out across the public administration so as to increase the transparency of salaries based on job descriptions and also to simplify salary calculations.

Taking a whole-of-government approach to the State public administration

The ability to move human resources within the public administration as needed to deliver on the government's agenda requires staff to have the skills, experience and mind-set to work in a flexible environment. This starts with the expectation (through employer branding and vision) of what working in the public service involves *(e.g.,* flexibility and mobility); supporting employment frameworks *(e.g.,* transparency of salaries and conditions); and planning the workforce to ensure that the right people *(e.g.,* skills and experience at recruitment and through continuous training and development), are hired at the right time and placed to best deliver on the needs of government.

Setting expectations through employer branding

Achieving a whole-of-government approach requires a public administration that has a vision of where it is headed and a culture that facilitates the achievement of that vision. Employer branding contributes to forming a culture of how the public administration will operate – in the case of Estonia, working in a whole-of-government manner. Employer branding is essential for communicating to both internal and external audiences what the public administration stands for and what sets it apart from other employers. It helps to differentiate the central public administration as compared to other administrations (such

as at the sub-national level) and to the private sector; it is what differentiates the public administration as an employer of choice. Employer branding in the public sector, if linked to values and strategic vision, can help set expectations for existing and new staff about what it means to work in Estonia's state public administration.

Developing a "brand" should ideally reflect the direction in which the public administration is headed, *e.g.,* the desired vision, the values and behaviours governing working relationships, as well as the desired characteristics and values of the people it hopes to attract, *e.g.,* their skills, experience, level of competence, expected behaviour and mindset. Employer branding needs to be an honest offering of what the public administration stands for, the work environment that will be provided and the value placed on the use of public resources.

All internal structures, processes and frameworks need to support the image that is put forward as part of employer branding. The branding needs to permeate all aspects of HR and organisational planning within the public administration – including recruitment and selection, employment frameworks, learning and development, performance management, workforce planning, strategic HR, etc. Working in a joined-up, whole-of-government manner is critical to ensuring the success of the implementation of employer branding and the nurturing of the organisational culture to support it.

As discussed throughout this chapter, in order for the Estonian public administration to work in a whole-of-government manner, the silo organisations that compose it need to collaborate and work in a joined-up manner as a single entity to efficiently and effectively operationalise the government's agenda and deliver services to citizens. As part of developing a shared vision for the public administration, Estonia should look to establishing a "brand" for the national public service and adjust internal HR mechanisms to support the achievement of the vision and employer brand. Australia (One APS – Thousands of Opportunities) and Canada are examples of countries with strong employer branding as single joined-up public administrations.

Increasing workforce flexibility through workforce planning and succession management

A public administration that works as a single entity needs to be managed as a single entity. This means that workforce planning in individual organisations should contribute to a larger workforce plan. The benefit of collaboration across units on workforce planning means that patterns of skill/experience gaps or over-subscription can be mapped. More integrated workforce planning also enables cohorts of employees to be tracked to ensure gender, age, ethnicity, skills balance now and projections into the future. It enables the public administration to have a holistic view of the public sector workforce to enable it to position staff where they are needed to deliver on the country's strategic objectives. In addition, economies of scale can be gained from a formalised single recruitment for certain skill sets such as accountants, lawyers, or IT specialists.

Integrated workforce planning requires that the public administration works in a whole-of-government manner. Currently, fragmentation and lack of strategic vision for the HR function across the Estonian public administration means that there is no whole-of-service focus on workforce planning. Workforce planning, when it does occur, is silo-ed and portfolio-based. Decentralised responsibility for HR means that ministries and agencies have responsibility for the HR arrangements in their own portfolios, where there is no central

authority within the public administration that has responsibility for overall HR planning for the public administration. Devolved responsibility for HR can still exist, but without a central overarching authority, planning efforts are disjointed and not linked to the achievement of an overall strategic vision for the public administration. This represents a serious risk to the overall efficiency of the public administration and its ability to be collectively flexible and responsive to the needs of the government.

Effective use of integrated whole-of-government workforce planning provides an invaluable tool for the public administration to efficiently manage its human resources. It enables a holistic view of the number of staff employed, their skills and educational profiles. Operationalising workforce planning across the public administration when combined with other activities to embed a whole-of-government way of working *(e.g.,* devolving HR responsibilities and establishing a more flexible employment framework) can be very powerful in helping the senior leadership of the public administration to develop appropriate organisational structures to support the achievement of the government's agenda. Mapping the staff already employed, their skills and where they are currently working enables a more efficient recruitment of staff across the public administration and also contributes to developing a more flexible state public service workforce.

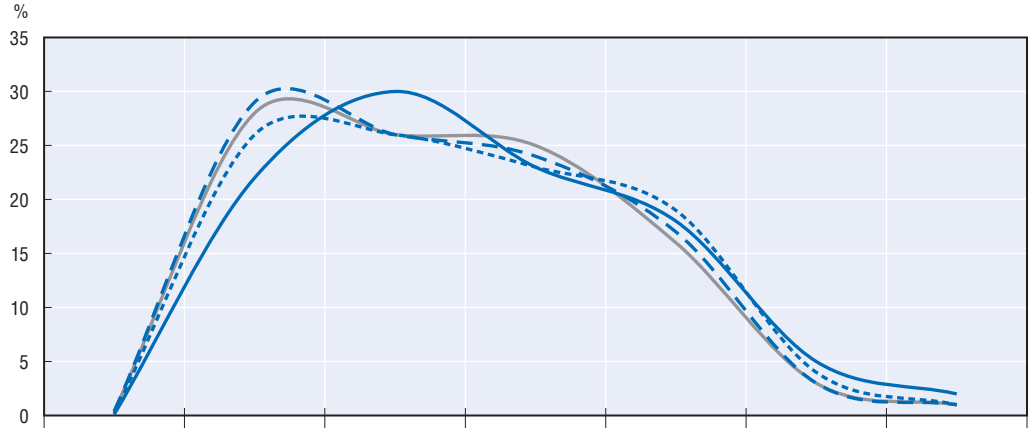
HR specialists are fundamental to the operation of the public administration; they ensure that the right people are attracted to working in the public sector, and help retain those staff already employed. Workforce planning in ministries, agencies and sector portfolios needs to be undertaken regularly by HR staff and integrated into strategic planning at the organisational level. Successful strategic integration is extremely powerful at providing a consolidated outlook for the business of the ministry/agency and ties together the human capital and business goals of the organisation. Despite the goodwill of those HR staff interviewed by the OECD, the largest obstacle they encounter is gaining the focus of senior management on HR issues. However, to balance this it should be noted that there is generally little HR capacity to undertake strategic HR activities and to gain the attention of and engage with senior management. That said, the integration of strategic HRM activities cannot occur unless senior management buys into the importance of staff in achieving organisational goals, which ultimately make operational the government's agenda.

While ministries are not responsible for HR in subordinate agencies, they are said to provide advice and information on best practice. However, it was identified that smaller HR units struggle to cope with the workload and have less capacity to undertake more strategic HR activities in addition to their administrative tasks. The personnel and training managers' network helps to share best practice information between HR managers. The scope of this group should be expanded to also focus on the sharing of best practice for the implementation of strategic HRM policies and practices. A central co-ordination body should also provide regular HR training for HR practitioners, including in more strategic HRM functions.

Workforce planning requires an accurate understanding of the composition of the public administration's workforce. A key indicator is the age distribution of staff in the public administration, where it is critical to ensure a balanced distribution of staff at different age cohorts across the public administration and within individual public sector organisations. This is important for creating a current and future staff ready and able to deliver the government's agenda, and for succession management purposes.

In looking at the age distribution of staff in the public administration, compared to most other OECD countries, Estonia has a relatively young public service workforce – with 52% of staff aged under 40 years. In 2009, 25% of employees were aged 51 years and over, of which 7% are aged 61 years and over. The majority of staff (53%) are aged 31-50 years. The youngest officials work in ministries and constitutional institutions, where the percentage of officials aged 21-40 in ministries is 66.4% and 54.2% in constitutional institutions. In 2008, there were 65.9% of officials in ministries and 52% of officials in constitutional institutions aged under 40 years, thus indicating, albeit only slightly, that the number of staff in these organisations is becoming younger. Figure 4.9 shows that Estonia will need to consider the impact of future retirements of the large cohort of staff currently aged 31-50 years.

Figure 4.9. **Distribution of state officials according to age, 1998-2009**



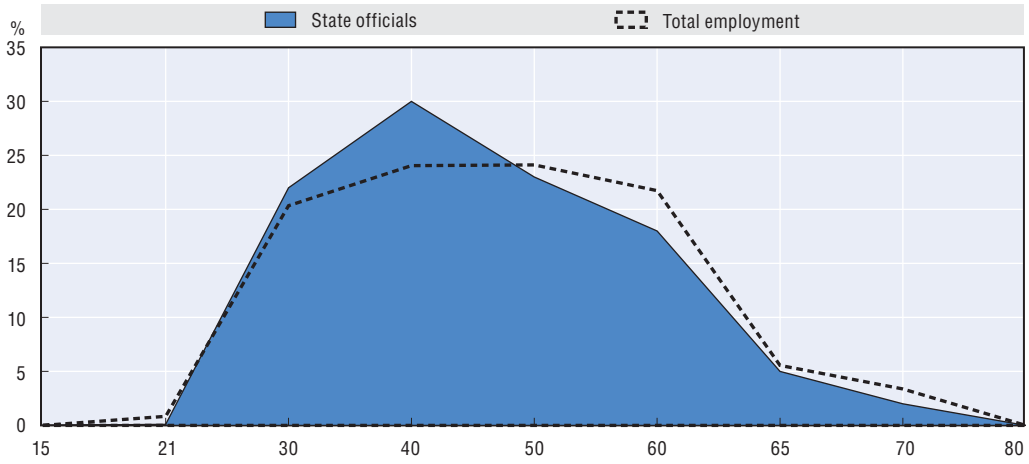
	Under 21	21-30	31-40	41-50	51-60	61-65	Over 65
1.07.1998	0.4%	28%	26%	25%	16%	3%	1%
31.12.2000	0.4%	29%	26%	24%	17%	3%	1%
31.12.2005	0.2%	26%	26%	23%	19%	4%	1%
31.12.2009	0.1%	22%	30%	23%	18%	5%	2%

Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

In the OECD countries selected for review, the demographic situation of the workforce in public services shows less variation than the demographic situation of the corresponding wider labour market. Examined by age group, the largest cohorts in the public services tend to be around 40-49 years, with an important proportion of employees in the age band 50-54 and 55-59 depending on the retirement age. In sum, the proportion of young employees is far smaller in the public sector of these countries[10] than in the private sector. In Estonia, the opposite is true: there are younger staff in the public administration than in the total workforce (see Figure 4.10).

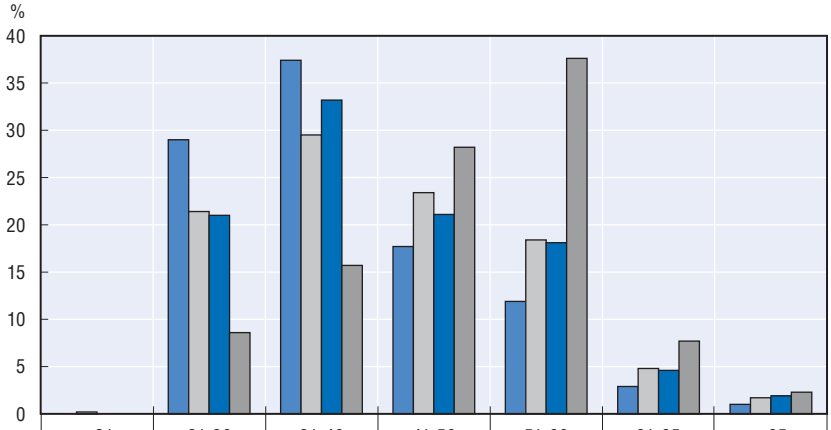
At the sub-national level, the number of staff aged over 51 in county governments is much higher at 47.6%, of which 10% are aged over 61 years and 75.8% aged over 41 years (see Figure 4.11). In local governments, just over half (57%) of officials in 2009 were aged 41-60 years. Immediate action needs to be taken to counteract the loss of capacity in country governments due to retirements over the coming 10-15 years. The public administration should start preparing for this now, to ensure that Estonia does not face similar problems as Finland, which is expected to lose 80% of senior leaders by 2015 and 90% by 2020; and 69% of middle managers by 2020 (OECD, 2007a). An ageing public sector workforce poses serious capacity problems,

Figure 4.10. **Labour force age structure: Total employment and state officials, 2009**



Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn; *Eurostat Databases* (2010).

Figure 4.11. **Age distribution of officials as of 31 December 2009**



	< 21	21-30	31-40	41-50	51-60	61-65	> 65
Ministries	0.0%	29.0%	37.4%	17.7%	11.9%	2.9%	1.0%
Subordinate agencies of ministries	0.2%	21.4%	29.5%	23.4%	18.4%	4.8%	1.7%
Constitutional institutions and their agencies	0.0%	21.0%	33.2%	21.1%	18.1%	4.6%	1.9%
County governments	0.0%	8.6%	15.7%	28.2%	37.6%	7.7%	2.3%

Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

particularly if staff are in management levels, as management employees tend to have a much higher average age than public servants as a whole and are thus nearer to their retirement.

OECD countries have been implementing a number of tools to help counteract the effects of an ageing public sector workforce. Estonia should implement a whole-of-public administration workforce planning and succession planning system so that it can anticipate and respond to the effects of workforce ageing that are about to occur in the county governments, and in 20 years over the wider public administration. Capacity maintenance tools include retaining older workers, targeted recruitment, career management and mobility. Cost containment/productivity increase measures include pension reform, efficiency savings and functional reviews.

Within the devolved HR system operating in Estonia, ministers are required to prepare four-year rolling strategic plans. Within these strategic plans, Ministers are required to include some level of "people" planning. However, it was highlighted to the OECD that this component of the strategic plans is vague and has a narrow focus only on staff numbers and salaries. Skills and capability needs are not included in the plans and are not addressed elsewhere. Estonia should also consider undertaking capability reviews within the public administration to determine areas of need.

While there is a need for a whole-of-government strategic co-ordination of workforce planning, a positive sign is that the Government Office has a whole-of-service succession management programme in place – the Newton Programme. The purpose of the programme is to identify executive potential in the Estonian civil service. The programme targets middle managers and specialists within the state administration to prepare them for senior management roles in the future. While on the right track, there has been some criticism that the programme could be two-tiered and also include a "leadership group in waiting" – those who are immediately ready to step into leadership roles, unlike the existing group, which is really some years away from being promoted. Estonia should expand the Newton programme to include possible future leaders, as well as those identified as being immediate replacements.

Developing capacity and capability

Estonia's relatively small and young public administration needs to be monitored and developed to ensure that it has the capacity and capability to work effectively and efficiently. This means that firstly, there are enough staff to undertake the work (as discussed earlier in workforce planning), but also that those staff have the right set of skills and experience. In small countries there is generally a smaller talent pool from which to hire staff, particularly for people with specialised skill sets. Without the right number of appropriately skilled people working in the public administration, it is difficult for the public sector to operate or be effective.

The public administration's ability to deliver the government's agenda is dependent on it having a workforce with specific skills and capabilities. Its efficiency and effectiveness in responding to government as a single entity requires constantly reviewing and updating skills and experience capabilities as needed. With a young workforce, the public administration needs to be careful to ensure that staff have sufficient skills and experience. Estonia has a well-educated public administration (see Table 4.6). From what the OECD has seen, this is not a critical problem for Estonia in overall terms, but there are certain skill sets that require attention, including strategic thinking, analytical capacity, management and leadership training, innovation and entrepreneurialism, citizen engagement, and performance management. Estonia should undertake a capability audit of the public administration to map the skill and experience sets currently employed and where they are located and to link this to whole-of-service workforce planning (as discussed in the previous section). Such capacity assessments should also, for example, include assessments of the distribution of officials by educational backgrounds as well as management and leadership skills, policy-making skills by subject area and sector *(e.g.,* energy policy and higher education policy), technical skills *(e.g.,* ICT, budget and financial, HR), etc. This should occur across the whole-of-government. Such assessments should be undertaken against existing government priorities and anticipated future needs. Estonia is aware of the need to map the skills and experience of its public servants – the Ministry of Finance has made some preparations to develop a system of job profiles which aim to support capacity assessments in the future.

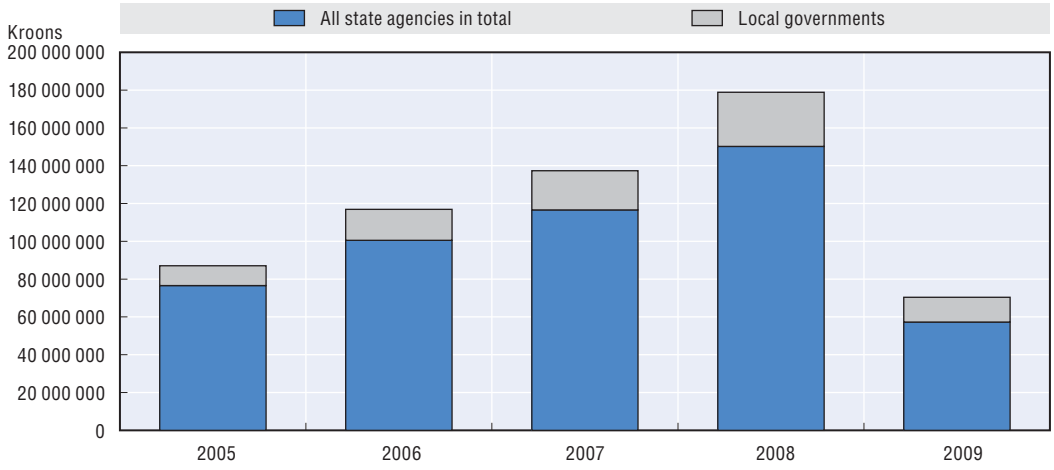
Table 4.6. **Distribution of officials by education level, as at 31.12.2009**

	Higher education	Master's level degree	Doctoral level degree	Vocational secondary education	Secondary education	Basic education	Number of officials acquiring further formal education
All state agencies	55.2	6.1	0.4	19.2	24.4	1.1	8.8
Ministries with their subordinate agencies	56.8	5.7	0.4	19.5	23.5	0.3	8.4
Ministries	85.2	17.4	1.3	5.6	9.2	0	10.4
Subordinate agencies of ministries	52.7	4.1	0.3	21.4	25.5	0.3	8.1
Professional Military	36.7	5.7	0.1	20.8	35.3	7.1	2
County governments	64.5	5.5	0	18.2	17.1	0.2	2.9
Constitutional institutions and Government Office with their subordinate agencies	80.8	18.9	2.9	7.4	11.7	0.1	15.7
Constitutional institutions and Government Office	81.6	21.5	3.7	8	10.3	0	16.8
Local governments	65.1	9.4	0.2	21.2	13.6	0.1	5.6

Note: Figures are the percentage of the sub-groups and not the percentage of the total number of officials in the public administration.
Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn.

In the Estonian public administration, staff training is a task for individual ministries and agencies where HR units in individual ministries and agencies are responsible for providing training to their staff. However, the Public Service and Public Administration department in the Ministry of Finance is responsible for providing horizontal training through the "Central Training" programme. This training is provided to state and local public servants free of charge (funded 85% from EU Structural Funds and 15% from the state budget). Current priority areas for horizontal training include ethics and core values; improving policy making skills; providing high-quality public services; Estonian language; and personnel management and other support services. A worry is that due to the global financial crisis, the training and development costs have been significantly decreased – dropping by 62% between 2008 and 2009 (see Figure 4.12). While this is understandable, attention should be given to ensure

Figure 4.12. **Public administration training costs, 2005-09**



All state agencies in total is comprised of Ministries, subordinate agencies of ministries, county governments, and constitutional institutions and Government Office with their subordinate agencies.
Source: Ministry of Finance (2010), *Public Service Yearbook 2009*, Ministry of Finance of the Republic of Estonia, Tallinn..

that an appropriate level of funds are provided to staff training and development to ensure that the public administration has the skills base it needs now and into the future.

Maximising responsiveness through a more flexible machinery of government

Public administrations cannot be static, and must respond to change not just at the policy level but also in the way in which it carries out its responsibilities. Faced with tightening fiscal environments, governments are increasingly placing demands on the public administration to be more effective and efficient – to do more with less. In the same way that the public administration needs the ability to move staff in order to meet the changing needs of government, the government also requires greater flexibility to instigate the machinery of government (see Box 4.13) changes to the structure and functions within the public administration, also known as administrative re-arrangements.

Box 4.13. **Definition of machinery of government**

Machinery of government refers to the systems and structures of government. It includes:

- the allocation of functions to and between ministries, agencies and other governmental organisations;
- the creation of new ministries or other governmental organisations;
- the amalgamation or abolition of existing ministries and other governmental organisations; and
- the co-ordination of the activities of ministries and other governmental organisations.

Source: Adapted from State Services Commission (2007), *Reviewing the Machinery of Government*, State Services Commission, Wellington, New Zealand.

In Estonia, there is very limited ability to undertake machinery of government changes. Under the *Government of the Republic Act*, ministries are identified by name (Section 45), and the areas of government ministries (Division 4, Sections 57-69) are specified, along with the accompanying executive agencies and inspectorates. This means that whenever the government wants to change the machinery of government, it must propose a legislative change to the *Government of the Republic Act* and have this agreed through a majority vote of the Parliament (51 of the 101 votes).

In order to increase the flexibility of the process of making machinery of government changes, incoming governments should have the authority to re-arrange public sector organisations or their functions as needed to best deliver the programme for the term of government. Furthermore, decision making responsibility for machinery of government changes should be devolved to the government, rather than needing to go to the Parliament for approval. These changes would require a revision of the *Government of the Republic Act* to transfer authority for making machinery of government changes to a non-Constitutional Act to enable changes to be made by the government as needed. Alternatively, decision making for machinery of government could be devolved to an administrative order to enable the government to make changes at its own will. Here, the *Government of the Republic Act* would need to be modified to acknowledge the role of the machinery of government, but for identification of each apparatus and structure of the administration to be deferred/devolved to an administrative order which can be amended by the government without Parliamentary approval.

On the other hand, Estonia could look to arrangements in New Zealand, where the State Services Commission is empowered to review the machinery of government across all areas. Under Section 6(a) of the *State Sector Act 1988*, a principle function of the New Zealand State Services Commission is to review the machinery of government across all areas of government, including: the allocation of functions to and between departments and other agencies; the desirability of, or need for, the creation of new departments and other agencies and the amalgamation or abolition of existing departments and other agencies; and the co-ordination of the activities of departments and other agencies. Such a function could be considered in Estonia as a means for the public administration to become more directly active in the review and recommendation to government of the appropriate structure and functions of various parts of the machinery of government. Analysis from such reviews could be used to feed into government decision making regarding possible machinery of government proposals.

Following on from the use of functional reviews, the budget process can also be used for strategic re-allocation and re-engineering of public sector functions. Programme reviews can be used as a mechanism for terminating, merging or re-allocating functions. The implementation of programme budgeting can assist in making the transfer of funding and performance outputs and outcomes more transparent and enable changes to machinery of government smoother (see also Chapter 5: "Building a Common Agenda").

While flexibility comes with many benefits, re-structures of the machinery of government should not be taken lightly. Opening the public administration to more responsive machinery of government can create instability if not managed effectively. Machinery of government changes and increased flexibility needs to be balanced against making too many changes. To be effective, central support may be needed to manage machinery of government changes and to support affected staff and governmental organisations. Extra funding may also be required to cover the set-up and corporate overhead functions associated with changes. In order to manage machinery of government changes efficiently, a machinery of government implementation handbook should be developed and utilised (similar to those used in Australia and New Zealand). This would help ensure a whole-of-government approach to restructuring. Communications, people management, project planning, ICT, and records management strategies – as well as financial management and performance indicators, and the monitoring of changes – should also be used to ensure the smooth transfer of staff and functions (Commonwealth of Australia, 2007).

Using ICT and shared HR service provision to support whole-of-government ethos

Estonia has been piloting the use of shared services for corporate services – for HR records management as well as financial management. This has been a politically driven process, stemming from an inability to have a consolidated view of human and financial resources going into the global financial and economic crisis.

There are two main models when developing shared services: *a)* shared services established by large organisations to provide HR services both to their own organisation and to external client organisations as an outsourcing of business; *b)* shared services set up by large and often multinational or multi-site organisations that aim to restructure their HR service provision through re-centralisation and the creation of an internal market system (Cooke, 2006). While the Estonian shared services programme currently seems to be focused on the first model, there is scope for further re-structuring in order to increase efficiency and to develop a more whole-of-government framework to support decentralised HR decision making.

Given the small size of Estonia's public administration, opportunities to centralise further HR practices may produce efficiencies. For example, in addition to centralising HR records management, other HR functions could be centralised as well, including a recruitment portal for the advertisement of positions; common recruitment principles; and a common individual performance management system (that is adaptable to the needs of each organisation). The ability to maximise the flexibility that can be gained through operating a decentralised system needs to be balanced with central co-ordination of key areas: including vision; recruitment principles; remuneration framework; etc.

The current Estonian approach to shared services is multi-polar, *e.g.,* a shared service centre for each ministry, as the government does not want to concentrate power in one ministry, *e.g.,* by establishing a centralised database for all of government, which would shift power to that ministry. Alternative models, however, could be to establish a shared service centre. For example, in an organisation at the Centre of Government, such as that implemented in the Ministry of Finance in Finland; or in a separate and independent organisation where such an organisation would not be under the control of any one ministry, but instead could work in conjunction with the Centre of Government. In both models the focus would be on rolling out common HR standards, salary frameworks, workforce planning, and training tools.

Notes

1. Social capital has been defined in numerous ways by economists and sociologists. For simplicity and the purpose of this report, social capital is defined as the range of contacts or relationships an entity (individual, organisation, government body) can draw upon in the pursuit of its objectives. Its value lies in its ability to help actors achieve their goals.
2. Secretaries General and Deputy Secretaries General of ministries, Directors General of Boards and Inspectorates, and County Governors.
3. It is noted that as of 31 December 2009, the annual review interview period had not been completed. As such, the personnel departments in administrative agencies did not have a full picture of the number of interviews conducted.
4. The Competency Framework of the Estonian Civil Service was updated in late 2010 to include four values and 10 competencies, of which co-operation has been included as a competency.
5. The data on reason for departures is unreliable due to the large percentage of unknown reasons for departure recorded.
6. The data on the number of staff moving between public sector organisations may be distorted by the high use of fixed term appointments, particularly among younger staff. Of those officials who entered into service in 2009, 32.9% of these entered into service from another public administration institution.
7. The Estonian Ministry of Finance defines "turnover" as only including voluntary leave of service and excludes involuntary leave of service – thus separating voluntary and involuntary staff turnover. Reasons for involuntary turnover include the expiry of a term of service, the winding-up of an administrative agency or dismissal; where voluntary turnover is determined when the staff member initiates and chooses to leave the service. In the case of voluntary leave of service the organisation must refill the vacant post, whereas for involuntary leave of service the position is not usually refilled.
8. Source: *www.avalikteenistus.ee/public/Development_of_public_service_1991_2006.pdf*.
9. Source: *www.fin.ee/index.php?id=82209*.
10. Countries surveyed included: Australia, Austria, Belgium, Finland, France, Hungary, Ireland, Japan, Korea, Luxemburg, Mexico, Netherlands, Norway, Portugal, Sweden, Switzerland, United Kingdom, and United States, as reported in OECD (2007), *Ageing and the Public Service: Human Resource Challenges*, OECD, Paris.

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Chapter 5

Building a Common Agenda

Estonia's public administration functions on the basis of multiple strategic plans, many of which do not become operational. Given that 2013 marks the end of the current strategy planning period, Estonia's ministries and agencies have the opportunity to re-assess how they go about their planning and prioritisation, identify ways to build greater cross-sectoral collaboration, and better integrate strategic and budgetary planning. To this end, Estonia is looking to strengthen the links between strategic planning and budget frameworks, and intends to develop its performance budgeting processes as a means to improve capacity for decision making, prioritisation and accountability. Further enhancing its evidence-based decision-making capacity and building citizen engagement practices could strengthen Estonia's anticipative, innovative and adaptive capacity.

Introduction

Working in a whole-of-government manner can only be successful if that effort is being used to help achieve a shared outcome. Establishing and working towards shared goals requires governments to develop a common vision that reflects the public interest and that maximises the efficient and effective use of the country's resources. In a small and young country such as Estonia, particular attention must be paid to directing its limited resources towards achieving the government's agenda. To maximise the impact of available resources, both public and private, they must be focused in the same direction to achieve a common outcome. But first, it is necessary to agree in which direction the country should be heading.

A multitude of strategic plans currently exist in Estonia, and many strategic perspectives do not fit into the whole-of-government vision; these could be easily left out of decision making around resource allocation. While the government can and should continue to prioritise, it also needs to improve its ability to synthesise and respond to multiple perspectives and information sources. This requires an ability to understand and balance government values, societal preferences, current and future costs and benefits, and expert knowledge and analysis. It also requires using this understanding coherently for objective setting, decision making, planning, and prioritisation of public resources. This will require:

- enhancing cross-sectoral strategic planning;
- modernising the performance and budget system; and
- establishing frameworks for effective decision making.

Enhancing cross-sectoral strategic planning

The role of government is to represent the citizenry and manage the resources of the country to deliver policies, programmes and services that meet the needs and foster the ideals of the country as a whole. As part of this, governments are expected to visibly and succinctly articulate their vision and programme for action for the achievement of both short- and long-term objectives. Governments must therefore understand the needs and desires of the citizenry, and have an agreed shared vision for where the country would like to head in the longer term, which they translate into consecutive government programmes.

Implementing a long-term vision for a country first requires establishing a vision and putting in place an effective strategic planning system/framework through which governments and the public administration can translate strategic objectives into actionable programmes and services that are delivered to the citizens – objectives which take into account the views of the citizens being represented.

Developing a longer-term, whole-of-government strategic agenda will help to provide Estonia with renewed direction

As a small country, Estonia must maximise the use of its limited resources towards the achievement of a focused vision for the country. To be effective, such a shared vision needs

buy-in from all sectors so that both private and public finances can be channelled to support the achievement of the future vision for the country. Achieving this will require inter-related short-, medium- and long-term planning based on a whole-of-government vision, understanding and knowledge.

Punching above its weight, Estonia has been making a name for itself on the international stage. To date, this has been achieved by working as a "project nation" focused on short-term projects such as European Union, NATO and euro area accession and membership. These projects were very goal oriented with clear parameters, timeframes, deliverables and milestones, and with identifiable resource allocation requirements. While these short-term projects have long-term consequences and also provide a springboard from which to further develop and position itself as a competitive country, the citizenry is now asking: "What is next?"

It has been said that during the global financial and economic crisis, the Estonian people started looking and asking for a vision for the country. This becomes apparent when monitoring the Estonian media and press, which reveals a clear demand for a big-picture view beyond any one sector. Estonia needs a vision that is ambitious and inspiring, and which spans across electoral terms, that can provide the substance for a discussion leading into an election.

The return of independence has given Estonia back its voice, and understandably it will take time to nurture and grow beyond the current phase, which has mainly consisted of setting and achieving short-term goals for the re-establishment of the country. The next phase is entirely up to Estonia to discuss, agree and share as a country. Over the past 20 years, Estonia has had time to consolidate and focus, making it ready to establish a shared long-term direction for the future. While Estonia is aware of the need for longer-term planning, its current roadmap for the future relies on medium-term strategy documents rather than actually developing an over-arching long-term shared vision for the country.

Estonia currently has three key horizontal documents in place which are said to provide the main strategic direction for the country (see Box 5.1). These are the:

- Estonian Strategy for Competitiveness (2009-11).
- National Security Strategy (revised in 2010).
- Sustainable Estonia 21 Strategy (2005-30).

It is anticipated that these strategic vision documents (with the exception of the National Security Strategy) will be replaced in the future by one strategic document. Currently, a national competitiveness strategy, Estonia 2020 is being developed, which describes how Estonia will achieve the EU2020 objectives. The Strategy Unit within the Government Office, with the assistance of ministries, recently undertook an *ex ante* analysis of the key challenges related to increasing Estonia's competitiveness for the purpose of establishing policies related to the development of the Estonia 2020 Strategy.

In developing the Sustainable Estonia 21 Strategy, the Estonian Strategy for Competitiveness Strategy, and the Estonia 2020 Strategy, the government missed an opportunity to develop a shared long-term vision for the country as a whole. While a step in the right direction, these strategies were developed and driven by a need to meet requirements for EU membership. In and of themselves, they do not provide a coherent, over-arching shared strategic societal agenda for the country that includes broad input for achieving economic,

Box 5.1. **Estonia's horizontal strategic documents**

Estonian Strategy for Competitiveness (2009-11)

The Estonian Strategy for Competitiveness (2009-11) is an update to the Estonian Strategy for Growth and Jobs (2008-11). The Estonian Government adopted the Strategy for Growth and Jobs 2008-11 in September 2008, as Estonia's strategy for implementing the EU's Lisbon Strategy. It presented nine goals for improving Estonia's competitiveness as a country and links decisions of the Government with the strategy for growth and jobs. It also describes plans for new government measures and priorities. The strategy was updated (2008-11) in response to the impact of the global financial and economic crisis, to take into account the changed economic environment and the government's response to the crisis.

National Security Strategy

The National Security Strategy, adopted in May 2010 by the *Riigikogu*, replaces the 2004 strategy and presents the objectives, principles and directions of Estonia's security policy. The Strategy is revised and amended depending on changes in the security environment and development of measures for ensuring Estonia's security. The Strategy constitutes a framework document, forming the basis for the preparation of specific development and action plans.

Sustainable Estonia 21 Strategy

The Ministry of Environment started developing the Sustainable Estonia 21 Strategy in 2001. The strategy, developed in response to EU requirements, proposes goals and courses of action to provide a foundation for public understanding of sustainable development of Estonia (Ministry of the Environment, 2005). This exercise quickly turned into a much broader-focused and horizontal project at which point its management was taken over by the Government Office (previously known as the State Chancellery). The Strategy, which was approved by the *Riigikogu* in 2005, lays out plans for developing the Estonian state and society through 2030, with the aim of integrating the success requirements arising from global competition with the principles of sustainable development and preservation of the traditional values of Estonia. It has four main goals: social cohesion; viability of cultural space; growth of welfare; and economic balance. It contains sets of indicators associated with each of the four main goal areas, but not all of these are operational; some are more theoretical and others have no established methodology. Its development and management is overseen by two working groups, one which is technical and deals with strategy's implementation, and the other which is a higher-level group that serves an advisory role, approves studies and reports, and sets the path for focus topics. The lower-level working group has had some success at establishing some concrete outcome indicators, which are evaluated every two years. Information for these indicators comes from official statistics surveys and/or administrative data sources.

environmental and social outcomes, for shaping future opportunities for competitiveness, and for managing risks.

Without a coherent strategic vision for the long-term future that has the support of citizens, political parties, the public administration, business and civil society, Estonia faces missed opportunities to address social, environmental and cultural challenges and to maximise the country's economic growth. The effects of the recent global financial and economic crisis have further contributed to narrowing the scope of government action, where, for example, the National Competitiveness Strategy was adjusted. Estonia survived the crisis better than many other OECD countries due to its sound budgetary response. But,

while budgets are adjusted in response to changing economic conditions, strategic documents should not be – especially in a country like Estonia which already has very low national public debt.

The Estonian public administration is aware of the need for strategic planning; however, both the government and public administration have yet to fully realise the benefits and role that a shared strategic vision with a long-term horizon – as opposed to just the development of strategies – can have in shaping the country. While, among them, the three strategies take Estonia to 2030, these do not constitute an over-arching whole-of-government strategic vision. While there are many strategic plans in place, there is no vision that shapes the long-term strategy for Estonia's future into a coherent plan. There is no unifying concept of what Estonia wants to achieve as a country.

To be successful, effective and enduring, the development and implementation of a shared strategic vision for Estonia needs buy-in from all political parties. This is to ensure it has legitimacy across more than one electoral cycle. Such an agenda should ultimately be discussed and agreed by the *Riigikogu* to ensure its longevity. Achieving a common shared vision for the country and sticking to it over time should be easier for coalition governments; however, it has been suggested that government circles in Estonia have difficulty seeing beyond election cycles. This is where the involvement of the country's President could also be helpful in developing a longer-term shared vision for the country that is used by coalition governments across more than one election cycle.

In Estonia, the President's Office is influential in terms of agenda setting, where it does challenge the government – albeit very carefully. Presidents are elected for terms of five years (and can stay in office for no more than two terms) and have a visual, non-partisan role. There is a role for the President to take a leadership position to drive the need for the development of a shared strategic vision for the country, and to champion the political and sector support needed to make it happen and to be maintained across the medium- to longer-term. The position of President has an influential role with citizens through speeches and public addresses, can help unify political parties and factions, and rally citizens.

Estonia could look to undertake a staged introduction to the development of a long-term shared societal vision. In the shorter term, opportunities could include involving social partners to expand the scope of the Estonia 2020 strategy, then in approximately three to five years the government could aim to lengthen the time horizon for such a strategy. Estonia could also look to other countries and adapt a process for developing a shared strategy that suits its own context.

In considering how to engage stakeholders outside of the government and the bureaucracy to help develop a shared long-term vision for the country, Estonia could look to Australia's 2020 Summit for an example of how to seek community input and buy-in to the development of a shared country vision. Australia's successful consultation processes engaged key societal stakeholders in developing a shared societal vision for the country. The government convened a summit to foster a national conversation on the country's long-term future. The summit resulted in a report, which was used by the government in the development of forthcoming policies and programmes.

In terms of engaging the public administration and Parliament, Finland provides a good example of formal reporting that takes a cross-sectoral and longer-term approach. Finland has been undertaking Horizontal Government Foresight Reporting for approximately 15 years as a formal process regulated by the Finnish Constitution. In Finland, the foresight

reporting procedure is used to create dialogue between Parliament and Government on futures-related issues. The reports have two purposes: *a)* to allow governments to outline their long-term objectives and choices relating to the issue under consideration and provide a framework for subsequent government decision making, while advising individual ministries on points of action; and *b)* to create opportunities for public debate on long-term future developments. This cross-sectoral approach could be a useful starting point for Estonia in terms of thinking long term and horizontally across sectors on futures-related issues.

Over the longer term, the Estonian government may want to consider how it can broaden discussions, both in terms of who it brings to the table and issues covered. For example, Ireland has broadened its traditional social partnerships relationship to include the community and voluntary sectors in addition to trade unions, farmers and employers' organisations. The resulting social partnership agreement, which has a 10-year framework, has been used to help maintain a strategic focus on key national priorities. The shared overall goal of "Towards 2016" was to realise the vision by nurturing the complementary relationship between social policy and economic prosperity; develop a vibrant, knowledge-based economy; re-invent and re-position Ireland's social policies; integrate an island-of-Ireland economy; and deepen capabilities, achieve higher participation rates and more successfully handle diversity, including immigration (Department of the Taoiseach, 2006). This is a partnership approach which focuses on dialogue for reaching common objectives and not just on contentious issues.

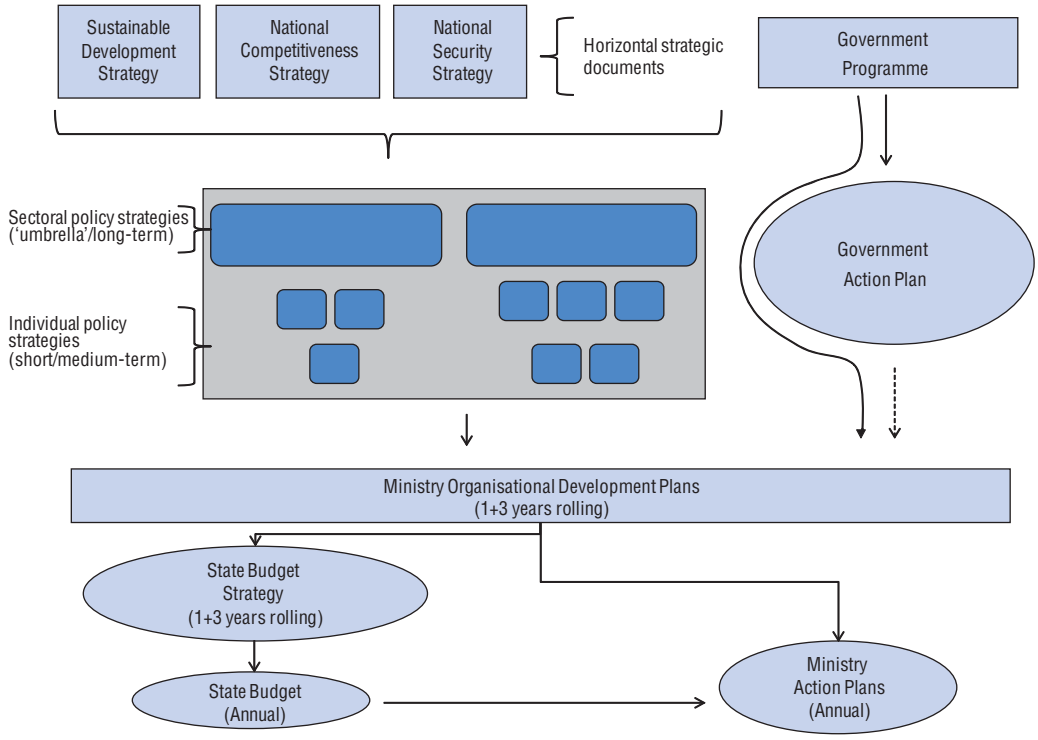
Strategic planning requires co-ordination, collaboration and prioritisation

Strategic planning is a key tool for scheduling required mechanisms and deliverables and ensuring that the right resources (financial and human) are available and positioned to implement the government's agenda – especially when linked to the budget process. It should be used to translate the government's agenda into actionable implementation deliverables by linking to budget and HR planning, and project and programme management and planning. Wherever possible, strategic planning should be: based on a whole-of-government vision, understanding and knowledge; dynamic; and address inter-related long- and short-term goals. While absent for some years, over the last five to seven years Estonia's central public administration has been taking steps to embed strategic planning into its practices and work culture. The extent to which these steps can continue will determine the future ability of the administration to efficiently and effectively operationalise the government's work programme.

The system of strategic planning in Estonia consists of three key areas (see Figure 5.1). At the top are a small number of broad horizontal strategic documents (as discussed in the previous section); these are followed by cross-cutting sector strategies approved by the government which include regular progress reports and contribute to an annual update of operational implementation plans; and finally, organisational strategies of ministries, which need to take account of what has been agreed in cross-cutting sectoral strategies and which are used as direct input into the preparation of the State Budget Strategy.

In between the three horizontal strategic documents and the sector and organisational strategies lies the Government Programme. Since the 1990s, Estonia has been governed by coalitions of various political parties. Following elections, the prospective governing partners negotiate a Government Programme. The current agreement covers the period 2007-11. Government Programmes are important for capturing overall budget policy

Figure 5.1. **Strategic planning in Estonia**



priorities, and provide broad guidance for spending plans over the electoral cycle. The Government Programme feeds the Government Action Plan, which is not a strategic document but rather sets the government's priorities, linking these to the Government Programme (it should be noted that the Government Programme has no legal status, but is rather informal – even though it forms the basis for all government plans). In addition to the Government Action Plan, individual ministries set their sectoral strategic priorities – first through an umbrella document setting out a long-term strategic vision and then with individual short-/medium-term strategy initiatives (see Figure 5.1).

Sectoral development plans (see Box 5.2) include the objectives of one or several sectors and the measures needed for their achievement. Their implementation is organised either by one ministry or several ministries in co-operation. Examples of sectoral plans include: the Transport Development Plan, and the Estonian Research and Development and Innovation Strategy. Organisation-based development plans include the area of government of a ministry, *i.e.,* a ministry and its subsidiary agencies. They are directly linked to the State Budget Strategy and cover the upcoming budget year and following three years. Each year, by 1 March, ministries update their development plan by one year in order to maintain a general four-year perspective. Realisation of organisation development plans is achieved through an annual action plan, which is a basis for planning the *Annual State Budget Act*.[1]

Strategic planning in Estonia is regulated by the *State Budget Act* and by Government Regulation No. 302 (of 13 December 2005). This regulation lays out the types of strategic plans developed by the ministries and the procedures for preparing, amending, implementing, assessing and reporting them. On the one hand, the legislative element behind strategic planning ensures the establishment of a planning process. On the other hand, it may

Box 5.2. **Process for establishing sector strategies**

Formal minimum requirements

- Duration of the strategy.
- Relations and links with other strategies and horizontal strategic documents.
- Information on inter-ministerial and stakeholder consultations.
- Thorough analysis of the state of play in the area, including assessment of the problems and possibilities within the sector.
- Strategic objectives that show the impact of policies (including measurable indicators and targets).
- Programmes and measures (with an indication of the key activities within these).
  - Detailed list of activities will be fixed in the operational plans.
- Main results of the impact assessment carried out.
- Estimated budget (will be adopted as indicative budget).
  - If the amounts exceed the levels of the existing State Budget Strategy, additional spending proposals need to be identified separately.
- Description of management and reporting requirements.

Process

- Before sector strategies are prepared, the Government approves detailed terms of reference for the proposed sector strategy (which is already agreed between ministries and partners).
- This is followed by the analyses that are still needed (questions that are not answered). Stakeholder and inter-ministerial discussions ensue.
- Various conceptual alternatives can be discussed at the unofficial Cabinet meetings.
- Drafting of the strategy document.
- Public web-based consultation.
- Inter-ministerial consultation (may be parallel with public consultation).
- Discussion and decision at the Government Session.

Source: Government Office (2010), Information provided by the Government Office of the Republic of Estonia, Tallinn.

contribute to the feeling that the system is too rigid, and hinder the government's ability to guide (or steer) the policy process in increasingly demanding environments.

The implementation of the strategic planning decree in 2005 had an initial impact of increasing the number of strategic plans operating in Estonia's public administration – ballooning to over 200. For a small country, this large volume of policy strategies was unmanageable, and served to blur strategic vision, coherence and prioritisation. However, over time and after some concerted effort by the Government Office the number of strategic plans in operation has reduced to approximately 70. While there has also been some effort to group strategies, it remains unclear how these link with each other and with the three "guiding strategies" (Sustainable Estonia 21 Strategy, Strategy for Competitiveness, and National Security Strategy) (see Figure 5.1). Hence, there may be missing links between the plans and the budget process; between ministries for policy co-ordination; between ministries and their agencies in implementation; and between the central and local

authorities. It is unclear how all the different plans and strategies link together to form a coherent path and vision for the county. Co-operation among ministries for strategic planning is difficult. The lack of clarity can also be linked to lack of political coherence on the vision for Estonia. While there is some level of sectoral co-operation in the development of strategies, participation by the Ministry of Finance and the Government Office is late in the process which inhibits the ability of these key actors to steer collaboration and co-ordination horizontally as well as to support linkages with higher level strategies (see Box 5.3).

Box 5.3. **Co-ordination mechanisms for strategic planning in Estonia**

The Estonian Centre of Government (Ministry of Finance and Government Office) has a key role in co-ordinating strategic planning. The Ministry of Finance has responsibility for the overall strategic framework. It prepares necessary regulations, raises awareness and provides guidance material, and undertakes quality control of sector strategies when these are consulted between ministries (verifying the financial information). The Strategy Unit in the Government Office is responsible for co-ordinating horizontal agendas across the public administration – including the National Competitiveness Strategy, the Sustainable Development Strategy, and the Government Programme – and for ensuring the coherence between sector strategies and horizontal strategic documents.

The Strategy Unit also takes part in the preparation of sector strategies and cross-cutting strategies. It analyses sector strategies, focusing on the objectives and substance of new strategies, aiming to ensure that they coincide with government priorities and the Government Action Plan and contribute to achieving long-term aims of the government. The role of the Strategy Unit also includes fostering the strategic planning environment by developing methodologies for strategic impact assessment and providing financial support for ministries and non-government organisations for the purposes of research and analyses on cross-cutting issues.

Both the Strategy Unit and the Ministry of Finance look at the quality of strategic documents. The Strategy Unit undertakes quality control of sector strategies before Government Sessions where strategies are approved, and provides advice to the Prime Minister.

Source: Information provided by the Government Office of the Republic of Estonia and the Ministry of Finance of the Republic of Estonia, Tallinn.

The lack of connection within the state administration appears to be more a horizontal issue – across portfolios and ministries – than a vertical one. There is translation of strategic priorities from over-arching portfolio strategies into subordinate organisational planning. During interviews with the OECD, officials called for the Ministry of Finance and politicians to develop better understanding of agencies' objectives when developing higher-level plans. This is also suggested for portfolio ministries, some of which were called "passive", particularly regarding the setting of targets. While agencies interact for ministry strategic planning, this could be further developed and enhanced.

Part of the stewardship role of the Centre, as described in Chapter 4, is to co-ordinate and to set out clear expectations about what ministries should be doing. Strategy co-ordination is the role of the Centre of Government, where both the Ministry of Finance and the Strategy Unit have important functions in relation to quality control, analysis, and co-ordination of strategic plans (see Box 5.3). Ensuring that whole-of-government strategic linkages are developed, implemented and monitored requires the Centre to strengthen its

stewardship role by identifying co-ordination needs and enabling the relevant actors to work together. The Government Office and the Ministry of Finance should play a stronger role in co-ordinating the development of cross-sectoral strategic plans and directly linking these to higher level strategic documents.

Strategic planning requires prioritisation

Ensuring that strategic planning documents are prioritised and follow a hierarchy is just as important as actually having strategic planning documents in the first place. Strategic planning documents that follow a hierarchy enable outputs and outcomes to be mapped to objectives. This increases the transparency of results to Parliament and the public. It also enables responsibility by cascading higher-level strategic plans through to lower-level plans, and links these to organisational and individual staff performance management. Finally, a hierarchy of plans helps the public administration to operationalise the government's agenda by prioritising objectives and outcomes.

While the strategic planning regulation provides guidelines for the development of strategic plans, there is no stipulation regarding a hierarchy of plans and their prioritisation (as can be seen in Figure 5.1); the high-level strategic plans are not directly linked to the Government Programme and do not directly feed into sectoral-specific plans. The tendency has been for ministries and government bodies to develop many plans, because having a plan approved by government is perceived to be helpful during budget negotiations. However, this seems to be the extent of their value, as only approximately one-third of plans are said to be actually used and monitored. In addition, strategic plans often grow apart quite quickly over time and are not updated or actively used as management tools – in this case, strategic plans tend to be static rather than dynamic.

While in theory, all strategic plans in Estonia have been agreed at the political level, these plans are not linked to an overall prioritisation system. While there are weak linkages between strategic planning and government budgeting, the budget does not fully support the achievement of strategic objectives. Problems with the quality of strategic planning means that, in reality, strategic plans are not linked through to the government's priorities and are developed in isolation. Budgets should support the achievement of strategic directions, and should interact with strategic plans, facilitating prioritisation. The political, rather than the administrative, level should prioritise competing goals between ministries. As Estonia has a number of strategic documents which are not connected to a hierarchy, it would be wise for a politically driven prioritisation to be undertaken.

The Ministry of Finance is aware of the need to prioritise Estonia's approximately 70 strategic plans and has undertaken preparatory analytical work to combine and rank priorities in existing strategic plans as a first step towards streamlining strategic plans and better integrating strategic and budgetary planning. However, this process is being handled as a technical process rather than as an active process of political decision making and trade-offs. A technical process is insufficient to develop a hierarchy of needs. Political involvement in the development process is needed to ensure that the resulting hierarchy of objectives has political ownership and buy-in. Rather than being managed by the administration, prioritisation for competing goals between ministries should be undertaken and agreed upon by politicians. For this to occur, however, a political-level process must be in place.

Many strategic plans will end on or around 2013, which provides the opportunity for further streamlining, prioritisation and integration of any new plans. Rather than focusing efforts to prioritise existing plans, it may be more useful to take the opportunity provided by the expiry of most strategic plans in 2013 to develop new plans within a hierarchical framework. This would enable a fresh start, rather than expanding analytical and political capital to prioritise existing plans which are due to expire.

Estonia could look to Poland, which provides a good example of how to achieve political buy-in to the prioritisation and alignment of strategic objectives. Here, six ministerial taskforces were established based on cross-cutting strategic objective areas, supported by a steering committee led by Deputy Ministers and teams made up of experts from relevant ministries and from civil society organisations. Recommendations from these groups were considered and approved by the ministerial taskforce before being adopted by the Council of Ministers (the Cabinet).

Monitoring and reporting

Mapping the work of ministries and agencies back to overall government priorities through strategic planning helps to better orient their work in support of the Government Programme, as well as to signal areas for improvement. It also increases the legitimacy of programmes and projects, and clearly identifies the strategic outcomes they support and the resources needed to achieve their work. Monitoring and reporting the achievement of government outcomes is critical to open and transparent democratic government. Reports need not only to be provided to government and Parliament, but also made available in a clear and understandable format to citizens.

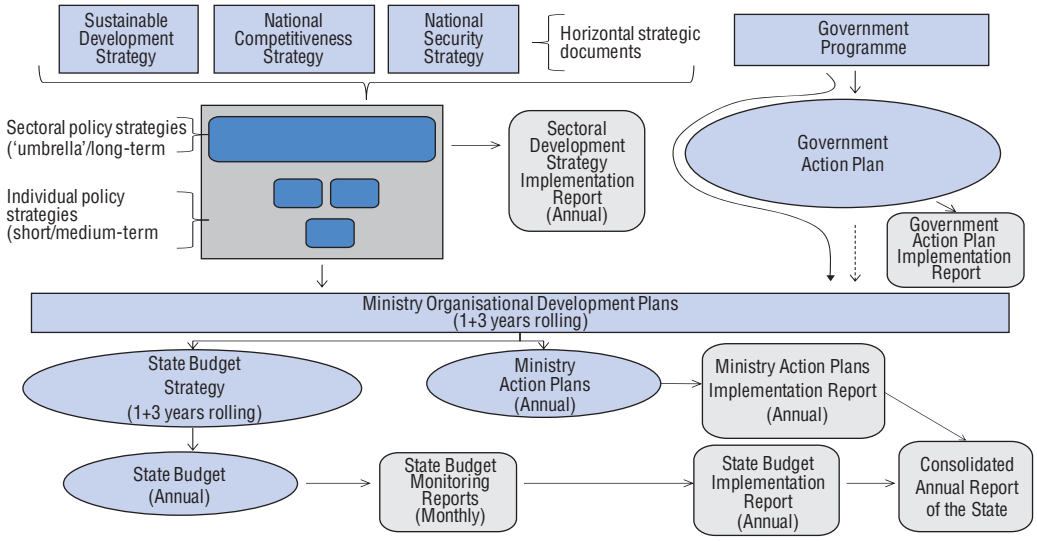
Since 2005, with the passing of the strategic planning regulation, ministries are expected to prepare an annual report on the implementation of their action plans. These are submitted to the Ministry of Finance and used to prepare a consolidated annual report on the state public administration, which is provided to the National Audit Office for independent evaluation; after this, it is approved by the government and the *Riigikogu*. In addition to annual action plan reporting, reports on sectoral development plans are also compiled annually pursuant to their implementation plans. These implementation plans and annual reports are not directly related to the organisational development plans or their execution reports.

While there is a strong incentive to produce plans as an impetus for budget negotiations, there are few levers to monitor and report on the use of these plans. First, performance activities and financial monitoring are not centrally co-ordinated or regulated. Thus, in order to obtain management information, state agencies and the government must monitor the execution of their activities and use of financial resources through internal methodologies and information systems developed on a needs basis. This is reinforced through a lack of uniform methodology or principles for tackling the effectiveness and impact of activities and clearly defined reporting criteria.

While the strategic planning regulation stipulates that Ministers are responsible for reporting on sectoral development plans to the government, the OECD has been advised that this does not always happen in practice – only approximately one-third of sectoral developments have discharge reports submitted to the Government. In relation to sectoral development plans (see Figure 5.2), reporting is not clearly linked to action plans via annual organisational development plans; reporting on sectoral development plans is

therefore not integrated into the rest of the system, and thus functions as a stand-alone process. The reporting of sectoral development plans does not involve sufficient co-operation with ministries participating in the development plan; instead, the lead ministry simply aggregates immediate results.

Figure 5.2. **State administration reporting**



Estonia should develop a clear methodology for evaluation and reporting on the achievement of the government's strategic outcomes. This requires development of a hierarchy of strategic plans, co-operation and co-ordination of planning, and development and discussion of a clear reporting framework. Such a framework should include the development of a clear methodology on the principles of reporting, ensure linkages between various strategic planning documents and reporting instruments, as well as clear responsibility incentives for reporting. It should also be used in conjunction with a performance budgeting system, which will be discussed later in this chapter.

Developing a capacity for strategic planning and foresight

While it is impossible to know what one does not yet know, building foresight and capacity for responsiveness is not impossible. Building the public administration's capacity to be anticipative rather than reactive requires thinking in the long term, in addition to the short and medium terms. While insiders quip that, in Estonia, four or five years is long-term, given Estonia's relatively recent re-establishment of independence, it will not always be the case. Building foresight skills now – not when the long term means 20 to 30 years in the Estonian context – will enable Estonia to take strategic and well-planned steps when faced with risk or other adverse situations.

Estonia has yet to develop and embed a foresight capacity within its public administration. There is no tradition or history of strategic planning. Upon the re-establishment of independence, Estonia lacked theoretical knowledge about how to run a government; the only experience was from the first Estonian State (1920-40). Unlike when Finland was occupied, Estonia did not retain a working government and public administration. There was expertise in implementation, but even by the mid-1990s, there was no real notion of strategy or

planning, which were concepts often equated with a Soviet way of working. As a rejection of things perceived to be associated with communism, Estonian society swung in the opposite direction in favour of an extreme neo-liberal viewpoint. Those appointed to government were just starting to become politicians, and there were few professional managers.

During the early 2000s, there was no apolitical co-ordination of strategy and substantive issues in the Government Office (then the State Chancellery), which was then a technical secretariat to the Prime Minister. The Prime Minister's Office was a political office that did not focus on substantive issues. The Government Office's Strategy Office was created in 2006. It plays a strong role in co-ordination, and thus far has worked effectively with the Ministry of Finance. This close working relationship is key to the success of the stewardship role of the Centre of Government, but to the extent that it is founded on personal ties, rather than on the institutional relationship between the two offices, the strength of this collaborative relationship needs to be reinforced and maintained. The Ministry of Finance has undergone relatively frequent ministerial structural reform, which has impacted continuity and the institutionalisation of strategic planning. The Strategy Unit, while newer, has had more experience in co-ordination and more history of continuity in that its staff have held positions of co-ordination in the past.

While it took some time to take effect, the introduction of the strategic planning regulation in 2005 has ultimately resulted in changing the level of pitching and quality of strategic planning documents. Strategies have become more systematic, transparent, logical and shorter – they have become clearer and better organised, to the point where they can now be used as tools for communicating strategy. However, the most important change has been in the minds of the experts writing the strategies, who have become more strategic in their thinking. It has been important for the experts to learn that strategies need to be well argued and the text needs to be easily communicated to everyone (*i.e.,* not written in bureaucratic language).

Foresight skills include scanning for trends, identifying patterns, and interpreting information from diverse sources. Such capacity resides in part within government, but is enriched and expanded when government taps into a variety of perspectives and takes a multi-disciplinary, multi-stakeholder approach. It also requires or involves innovative thinking, seeking out the new and breaking out of old patterns. Foresight skills need to be developed at the individual, leadership and organisational levels.

At the organisational level, the capacity of ministries to fix targets and strategic goals is limited; the weakest ministry may not sufficiently cover its needs. Each ministry has a department or position for co-ordination of planning and reporting activities. Their common tasks are: to act as the first contact point for questions relating to strategic management; to provide methodological support for policy departments in preparation of sector strategies; to prepare and maintain the Ministry strategic plan, which is updated annually; to provide co-ordinated input to the financial management department for budget reporting; and to provide progress reports to the Government Office on the implementation of the Government Programme. However, the co-ordination capacities for strategic planning tend to be very small, sometimes consisting of just one person, who may also have other roles such as for managing HR departments, etc. The strategic planning areas are separate from the financial management and budget departments, and while the role of the strategic planning department is to provide co-ordinated input to the financial management and budget departments, this is often not used in the preparation of budget

proposals, causing a disconnect between the development of strategic plans and the financial means for implementing them.

There is evidence that ministries have been supporting and/or assisting subordinate portfolio organisations, *e.g.,* agencies, with strategic planning. The most effective examples appear to be where ministries take the time to meet and discuss. However, generally many more end up learning from their mistakes. That said, there is evidence that agencies were able to move faster than the ministry and political levels to incorporate strategic planning in their operations. This is likely due to the service delivery aspects of the business of agencies which require a more disciplined planning framework. Many agencies had strategic planning in place prior to the introduction of the strategic planning decree.

Greater emphasis needs to be given to enhancing the capacity of the public administration to undertake foresight and strategic planning activities. This needs to occur as part of workplace training and also through formal qualifications. It was highlighted in interviews with the OECD that in Estonia there is little literature available on public sector strategic planning compared to that which is available in the private sector – in particular explaining the development and use of indicators. There needs to be an agreement on what strategic planning is and means in Estonia. The Ministry of Finance has developed templates and provided suggestions – but they were said to be too complicated and bureaucratic. University students need more training in public sector strategic planning. In addition, the Estonian public administration should look to further develop partnerships with national and international partners to build up the necessary frameworks and methodologies to support its strategic planning efforts. This work could take place, for example, in partnership with European institutions, notably under the framework of the administrative capacity building programme of the European Social Fund.

In Estonia, there are organisations which are currently undertaking foresight work. For example, the Estonian Development Fund has been operating since 2007 and is an independent organisation that combines venture capital for projects that are in the State's interests, particularly with respect to innovation and IT in public service, and long-term vision planning. The idea behind establishing the fund was a need for longer-term vision, and experimentation and initiatives in order to upgrade the Estonian economy. It is similar to NESTA (the National Endowment for Science, Technology and the Arts) in the UK and SITRA (the Finnish Innovation Fund) in Finland. The Fund gathers and synthesises knowledge, interprets it and generates discussion among stakeholders. Its discussions are multidisciplinary, so, for example, healthcare services could be discussed among hospital systems, tourism officials, and wellness providers – leading to dialogue that is often inter-sectoral and inter-governmental.

While there are those in the public administration who feel a long-term vision is not of concern, the *Riigikogu* has established the Development Fund, showing its concern with Estonia's capacity for foresight thinking and planning. The Fund was established by the *Riigikogu* and reports to it annually. This annual report covers trends in Estonia and globally, and is a way to bring the *Riigikogu* up to date on these trends and what they mean for Estonia. There is a presentation of the report, a discussion by the *Riigikogu*, and then a Q&A from MPs.

The question then becomes: how well is the work of organisations such as the Development Fund being integrated into the development of policies and programmes by the public administration, into government priority setting, and into the development of objectives and outcomes and strategic planning? Foresight is a critical skill and essential to ensure that governments have the information and vision needed to steer the country in a direction that

will maximise the use of its resources, but which will also balance that use against societal preferences to achieve a shared vision for the country. Estonia must develop capacity for foresight at the individual and organisational levels within the public administration – and allow the public administration and government to utilise the work being undertaken outside the administration – in order to further develop its economic competitiveness.

Lack of linkages between strategic planning at the central and local levels

The strategic planning of the Centre impacts local government in two ways. First, "global policy" initiatives, such as climate change, are undertaken by the central government, but implemented at a local level. Second, even for domestic policy, it is very possible for the central level to develop programmes to be implemented at the local level which do not align with local capacity. In Estonia, the change in secondary school curricula is an example. The Ministry of Education and Research reformed the national secondary school curriculum in order to provide students with more choice (aiming to increase competitiveness). However, local governments are challenged to implement this new policy due to a lack of resources (human and financial capital, as well as possibly infrastructure). Finally, most local governments over time have developed competence in the delivery of public and administrative services. However, they are not as skilled at developing and implementing their own strategic plans; thus, they may still depend on the Centre or a "higher level" of government for guidance.

The connection between central strategic plans (even line ministry plans) and municipal planning is weak in Estonia, both with respect to strategic decision making and to the development of municipal aims. State-level strategic plans are not aligning to municipal planning, and municipal-level aims do not necessarily align with state-level strategic priorities. While this may seem to be a natural result of municipal autonomy, there should still be links between central strategic plans and local governments.

On the national level, there are many plans and strategies, sectorally among line ministries and at the regional level through county development plans. Each county develops a long-term comprehensive document that focuses primarily on spatial planning, and also on what must be accomplished for social-economic development, which is influenced by national-level policies and goals. The core of development thinking is spatial planning, which is the primary task of county governments. These long-term documents are complemented by smaller development plans, which may stem from national legislation, *e.g.,* the need to co-operate for waste disposal. These plans do not have a legal status however, and do not have a state budget allocation. In addition, municipalities can block them by choosing not to participate (see Chapter 6: "Delivering Public Services Effectively").

At the local level, municipalities are obligated through the *Local Government Organisation Act* to establish a strategic development plan that takes into consideration the long-term direction for the municipality as well as its economic, social, cultural and environmental development. These often also include projects for EU funds. Municipal action plans are also established, which change annually and are adjusted based on the previous year's budget and accomplishments. These action plans can change frequently.

There do not appear to be mechanisms however that can help identify links between municipal plans and aims and those being developed at the Centre. Given the number of plans that need to align – central, municipal, and ideally county – municipal participation in the national strategy development might help promote a common agenda at the sub-national

level. Municipalities are indirectly involved in the national-level strategy setting process through the two national-level municipal associations. However, not all municipalities are association members. Improving communication and establishing more direct dialogue with municipalities in the strategy design phase may generate greater understanding of national aims, a sense of co-ownership with these aims, and create incentive for municipalities to ensure their own plans align with those of the Centre. This also helps build a whole-of-government perspective in the activities of the sub-national levels.

Modernising the performance and budget system

In a small country and small state such as Estonia, financial resources are relatively limited in comparison to larger countries and thus must be spent wisely. This means that officials need a clear picture of the current fiscal situation, the long-term forecast of current spending, where and how well finances are being spent, and the ability to move those finances as needed in order to meet changing needs.

Fundamental to the achievement of government policies and programme priorities is a well-functioning budget system. This requires grounding in a sound institutional and legal framework; clearly articulated and communicated budget formulation and approval processes; measurement of budget performance and use in decision making; flexibility in budget execution; and open and transparent financial accounting and auditing. These elements of the budget system should ideally be integrated. To achieve maximum effectiveness, the budget system should also be linked to strategic planning and personnel management to ensure that all resources (personnel and financial) are aligned to the achievement of government priorities. The national budget is the instrument through which resources are collected from the economy and should be allocated and used responsively, efficiently and effectively. A budget system linked to a country vision, values and context is critical to achieving this.

Since independence, Estonia has been at the forefront of institutional reform in the area of financial management, and has developed modern and efficient budgetary institutions (OECD, 2008a). In 1999, the *State Budget Act* was thoroughly revised to introduce modern budget procedures based on the principles of transparency, budgetary discipline, effective parliamentary scrutiny and comprehensive external audit. The revised *State Budget Act* prescribed a strict timetable, ensuring the timely approval of the annual budget law before the start of the fiscal year. It also created the Stabilisation Reserve Fund with a view to macroeconomic stabilisation and control of economic risks arising from emergency situations. In 2003, the *State Budget Act* was again revised, which introduced a strategic planning procedure for the medium term as well as the medium-term expenditure framework. In addition, carry-over rules were changed, resulting in a marked reduction in end-of-year spending rushes. In 2004, in an additional amendment, general procedures of internal audit were incorporated into the *State Budget Act* (OECD, 2008a).

Estonia has made considerable progress in reforming its financial management framework in a relatively short period of time. However, new challenges on the horizon *(e.g.,* escalating financial burden and critical workforce capacity issues as a result of a decreasing and ageing population and due to current high levels of unemployment) will place pressure on Estonia's fiscal reserves. This requires longer-term planning of fiscal resources and the ability to measure and report on the performance of the use of that spending. Increasing demand on Estonia's resources will require the ability to innovate and

to increase the efficiency and productivity of public sector resources, and the ability to prioritise spending and re-allocate resources flexibly.

The Ministry of Finance is aware of the influence of macroeconomic restrictions and the reduction of public sector expenses due to the impact of the global financial and economic crisis – which has created pressure for more effective and efficient use of budget funds. Due to the changed economic position, the allocation of additional resources in order to maintain and increase the volume and quality of state-provided public service is unlikely, and as a result, the government faces the challenge of improving the effectiveness of the provision of public services. In response to this, the Ministry of Finance has been undertaking preliminary work to further modernise Estonia's budget system. The detail and timing of any such possible reform will be critical to the future advancement of Estonia's fiscal performance and in the transparent and accountable use of the public's resources.

Maximising financial resources by utilising long-term fiscal projections

Even in small state administrations, certain public prerogatives – such as maintaining health and education systems – need to be fulfilled, independent of the size of the country. This requires the need to prioritise and limit the number of goals and activities pursued, the scope of action, and the means of delivery. Even more importantly, it is critical for the governments of small states to have a clear, up-to-date picture of the country's immediate, short-, medium- and long-term financial position to ensure that the use of available resources is maximised.

Estonia has, over recent years, been progressively strengthening the medium-term perspective in its budget process (International Monetary Fund, 2009); it currently operates a medium-term fiscal framework (with normative ceilings) set over four years as provided for by the State Budget Strategy (the State Budget Strategy is a descriptive document which details the fiscal consequences of current policies). Since 2001, the Government (by Government session) has, at an early stage in the budget process, considered and approved the State Budget Strategy, which is intended to provide a medium-term fiscal policy framework and also to articulate spending priorities (International Monetary Fund, 2009).

The State Budget Strategy is prepared based on spring medium-term macroeconomic forecasts (published annually in March) and presented together with revenue projections. An overview of the summer macroeconomic forecast (published annually in August), which underlies the annual budget, is presented to the *Riigikogu*, together with a full set of budget forecasts, in the Explanatory Notes to the budget. In the course of developing the macroeconomic forecasts (including fiscal projections), the Ministry of Finance has access to central bank and other macroeconomic forecasts. However, there is no macroeconomic model for forecasting purposes; the available data time series are too short, and fundamental structural changes have been frequent since the 1990s (OECD, 2008a). The IMF reports that macroeconomic and fiscal forecasting in Estonia has been difficult and imprecise in recent years, partly because of the uncertain impact of these structural reforms and due to Estonia's accession to the EU, which has inhibited the usefulness of formal macroeconomic models (International Monetary Fund, 2009).

In addition to the medium macroeconomic forecasts, the Ministry of Finance also prepares selected long-term forecasts. For instance, under its obligations as an EU member state (but, at the time of writing, not yet in the euro area), Estonia must provide updates to the convergence programme (from 2011 the stability programme), a requirement of which is the inclusion of scenario analysis for pensions (Republic of Estonia, 2010c). Estonia

provides long-term projections for the sustainability of its public finance in these reports, which are updated annually based on a four-year time horizon. In comparison, 27 of the 30 OECD member countries (as of May 2009) produce fiscal projections. The horizon used for projections varies, from 25 years in Korea to approximately 100 years in the Netherlands. However, most use a time horizon of 41-50 years (see Figure 5.3). Over half of all OECD countries prepare fiscal projections on an annual basis, five countries prepare them on a regular periodic basis (every three to five years) and two prepare them on an *ad hoc* basis (Anderson and Sheppard, 2009).

Figure 5.3. **Coverage and frequency of long-term fiscal projections by central government, 2007**

Frequency produced	Years covered					
	21-30	31-40	41-50	51-60	61+	Total
Annually			Austria, Belgium, Finland,[8] France,[8] Greece, Hungary, Ireland, Italy,[8] Luxembourg, Poland,[8] Portugal, Slovak Republic, Spain, United Kingdom[8]	Czech Republic,[2, 8] Sweden[3]	Denmark,[8] United States	18
Periodically (every 3-5 years)		Australia, New Zealand	Germany[4, 8] Norway, Switzerland			5
Ad hoc basis	Korea	Canada[5]	Japan[6]		Netherlands[7]	4
Total	1	3	18	2	3	

1. No fiscal projections reported by Iceland, Mexico and Turkey.
2. Czech Republic: Fiscal projections until 2060 in 2009, previously until 2050, otherwise identical to other EU member countries.
3. Sweden: Fiscal projections until 2060 in 2009, previously until 2050.
4. Germany: Fiscal projections are also published annually as part of its stability programme reports to the European Commission. The projection for the Commission is adapted from the government's Report on the Sustainability of Public Finances published within four years of the previous report.
5. Canada: Fiscal projections have been published by way of staff working papers on an *ad hoc* basis.
6. Japan: Fiscal projections were prepared in 2007 by the Council on Economic and Fiscal Policy until 2025 and the Financial Systems Council within the Ministry of Finance until 2050.
7. Netherlands: Fiscal projections are also published annually as part of its stability programme reports to the European Commission. The projection for the Commission is adapted from the independent CPB Bureau for Economic Policy Analysis ageing reports published on an ad hoc basis.
8. Countries also publish an approximation of the intertemporal budget constraint. In the case of European Union member states, this corresponds with the S2 indicator, i.e. the size of the permanent budgetary adjustment necessary for the gross consolidated debt to reach 60% of GDP over an infinite period of time.

Source: Anderson, B. and J. Sheppard (2009), "Fiscal Futures, Institutional Budget Reforms and Their Effects: What Can be Learned?", *OECD Journal on Budgeting*, Vol. 2009/3, OECD, Paris.

Long-term fiscal projections are a key tool for providing governments with strategic foresight capacity and communicating strategic choices to citizens and other stakeholders. Projections assess fiscal sustainability of current (expenditure and revenue) policies based on a number of demographic and economic parameters. They provide governments with invaluable signposts that enable them to make decisions that respond to known fiscal pressures and risks in a gradual manner; such pro-active responses prevent governments from adopting sudden policy changes. Planning ahead also helps to stabilise the fiscal future, costing governments less than if they had acted at the last minute (OECD, 2010f).

In the long term, fiscal pressures and risks are mostly based on demographic change, global climate change, and contingent government liabilities (see Box 5.4). Governments need indicators, like long-term fiscal projections, that will help them to get a handle on

Box 5.4. **Nature of long-term fiscal pressures and risks**

Fiscal sustainability implies four main characteristics:

- solvency, or governments' ability to finance existing and probable future liabilities/ obligations;
- growth, or the capacity of government to sustain economic growth over an extended period;
- fairness, or government's ability to provide net financial benefits to future generations that are not less than the net benefits provided to current generations; and
- stable taxes, or the capacity of governments to finance future obligations without increasing the tax burden.

While the level of government debt – and whether it rises or falls – is an important indicator of fiscal stability in the medium term, it is not a sufficient measure of fiscal sustainability in and of itself. In the long term, fiscal pressures and risks are mostly based on demographic change, global climate change, and contingent government liabilities. Governments need indicators, like long-term fiscal projections, that will help them get a handle on these risks.

Demographic change includes changes in fertility, longevity, and the age structure of the population. These changes affect government spending through mandatory age-related outlays, such as public pensions, health spending and care for the aged; and government revenues, such as when the tax base shrinks as the old-age dependency ratio increases. As populations across OECD member countries are ageing, and transfers to and spending on older people are rising, the old-age dependency ratio is an important factor in assessing a country's fiscal future.

Climate change may require new public spending and investment to adapt to extreme weather and low-probability/high-impact climatic events, many of which are likely to be national in scope. Fiscal risks may be related to public insurance schemes. The uncertainty and irreversibility of climate change require balancing the need for precautionary spending against the risk of undertaking costly expenditures that may eventually prove unnecessary.

Government contingent liabilities are potential obligations whose budgetary impact is dependent on uncertain future events. These obligations are hard to estimate because future events are hard to predict and because the amount associated with the obligation cannot be reliably forecast. Government contingent liabilities – including guarantees on government loans, investments and insurance schemes, bailouts of the banking sector, state-owned enterprises and sub-national governments, uncertain public-private partnerships, and natural disasters – have in the past provided some of the largest fiscal risks for industrialised countries.

Source: OECD (2009), "The Benefits of Long-Term Fiscal Projection", *OECD Observer, Policy Brief*, OECD, Paris.

these risks. Estonia's decreasing and ageing population and critical workforce capacity issues will place pressure on its long-term fiscal sustainability. Estonia should look to expand the expenditure categories used in making its long-term fiscal projections and embed the use of long-term fiscal projections into the annual budget process and government decision making. Although most OECD countries prepare fiscal projections, linking these projections to other budget practices and procedures remains weak in many OECD countries (Anderson and Sheppard, 2009). In these countries, fiscal projections risk being considered solely as analytical exercises by economists rather than by policy makers and decision makers.

Fully utilising long-term fiscal projections will ensure that Estonia is able to achieve its budget balance objective into the future. OECD countries which have integrated and embedded long-term fiscal projections into their annual budget process and documents and which could provide useful examples for Estonia include: Australia (Australian Intergenerational Reports); Norway (Long-term Perspectives for the Norwegian Economy); and the United Kingdom (Long-Term Public Finance Report).

Linkages between strategy and budget could be further strengthened to enhance resource flexibility

Aligning and fully integrating strategic planning and budget frameworks ensures the means by which to achieve the government's policy agenda. Firm linkages between strategic and budget frameworks enable the tracking of government spending against the achievement of policy outcomes, and force prioritisation of objectives when faced with limited resources. Without a very clear understanding of where public finances are being spent and for what value, it is very difficult for governments to prioritise policies and programmes and to steer implementation.

In recent years, Estonia has taken steps to increase linkages between strategic and budget frameworks. The implementation of strategic planning as part of the 2003 revision of the *State Budget Act* resulted in the adoption of an annual State Budget Strategy on a four-year, rolling basis. The State Budget Strategy provides: the budgetary policy principles; the priorities of the government and their activity-based funding plans for the four years; as well as an analysis of the economic situation and a forecast of economic development.[2] In January of each year, the Ministry of Finance issues a budget circular to ministries providing the timetable for the preparation of the budget strategy. In Estonia, the budget formulation process commences one year prior to the beginning of the relevant fiscal year, which coincides with the calendar year (see Table 5.1). It should be noted that a State Budget Strategy has been issued every year since 2001. However, during the global financial and economic crisis of 2009 and 2010 the strategy provided broad budget goals but no detailed targets or financial information due to the changing nature of the budgetary situation.

Table 5.1. **Timetable for budget formulation**

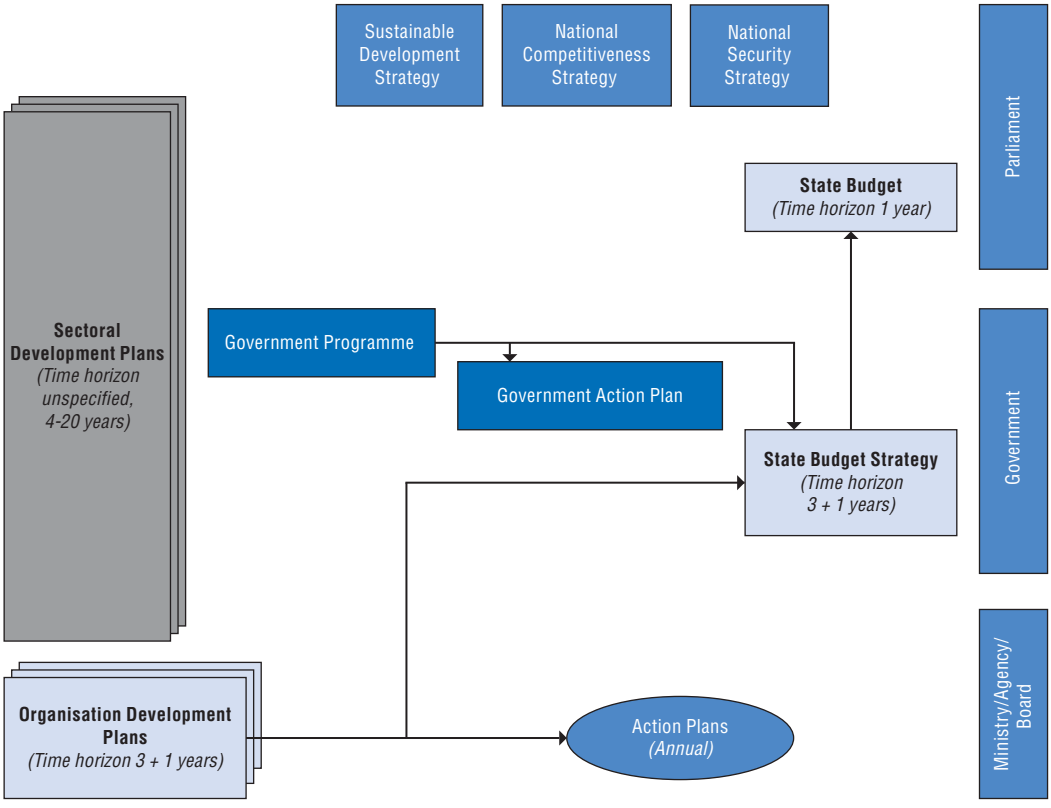
	Activity
January	The Ministry of Finance issues the budget letter and a timetable to the constitutional institutions, the Government Office and the ministries
February	The relevant minister discusses the organisational development plans with the Prime Minister
1 March	The constitutional institutions, the Government Office and ministries submit a four-year Organisational Development Plan, together with a financial plan, to the Ministry of Finance
March	The Ministry of Finance publishes the spring macroeconomic forecast
April	The Ministry of Finance negotiates with the constitutional institutions, Government Office and ministries and prepares the draft State Budget Strategy for discussion in the Cabinet
May	After the discussions in the Cabinet the State Budget Strategy is approved by the government
June	The Ministry of Finance issues (on the basis of the State Budget Strategy) the conditions of drafting and submitting budget drafts
July	The constitutional institutions, Government Office and ministries submit draft budgets for the next year's budgetary year to the Ministry of Finance
August	Budget negotiations between the Ministry of Finance and constitutional institutions, the Government Office and ministries. The Ministry of Finance prepares the draft budget for discussion by the Cabinet
August	The Ministry of Finance publishes the summer macroeconomic forecast
September	The Cabinet approves the draft budget and memorandum, which is presented to the *Riigikogu*
December	The *Riigikogu* adopts the budget (as the *State Budget Act*)

Source: Information provided by the Ministry of Finance of the Republic of Estonia, Tallinn (2010).

Ministries are required to present their budget bids as Organisational Development Plans based on programmes with four-year (rolling) expenditure projections (the budget year, plus three out-years). This serves as the basis for the preparation of whole-of-government four-year projections, which are presented to the *Riigikogu* in the annual budget and State Budget Strategy.

As part of the development of the annual State Budget Strategy, ministries submit an Organisational Development Plan with an attached financial plan to the Ministry of Finance. These draw on the previous year's State Budget Strategy, with typically around 5% variation in the figures in non-election years and more in election years (OECD, 2008a). Organisational Development Plans are developed based on sectoral policy strategies and elements of the Government Programme as operationalised by the Action Programme of the Government (see Figure 5.4). Linking sector strategies to the budget process is more realistic in a stable economic environment, but the success of ensuring coherence between sector-based plans and the budget lies primarily within the top management of each ministry, which, in turn, requires the guiding and controlling roles of the Ministry of Finance or the Prime Minister's Office (State Chancellery, 2010b).

Figure 5.4. **Strategic planning in Estonia showing area of responsibility**



The Organisational Development Plans are divided into programmes and sub-programmes. Programmes in the Organisational Development Plans do not cut across ministries, but they can cut across government agencies which are subordinate to ministries. The Organisational Development Plans are consolidated by the Ministry of Finance in April to form a draft State Budget Strategy (see Figure 5.4). The State Budget

Strategy is structured by policy area and provides a "goal", "sub-goals" and "key activities" together with "results expected" by the end of the four-year period.

In theory, the state budget is developed with strategic alignment. However, in practice the linkage between strategic and fiscal outcomes in the budget are loose. There are several reasons for this. First, the three key vision documents (Sustainable Estonia 21 Strategy and National Competitiveness Strategy – to be replaced by the Estonia 2020 strategy – plus National Security Policy Strategy) are not directly represented in the Government Programme or in Ministry Organisational Development Plans. Therefore, there is no direct visual connection between the goals and objectives of the strategic vision documents for the country and actual fiscal appropriations to be achieved in the budget. Second, responsibility for the linkages between strategy and the budget are left to the ministries. This is problematic when the finance and strategic planning areas within ministries are most often separate units that communicate infrequently and generally do not understand each other's work. Finally, there is also a missing link between strategy and budget in the budget process, where ministries prepare budget bids based on a programme of work and the government decides an expenditure ceiling which may not reflect the full bid submitted by the ministry. As these expenditure ceilings are used to adopt the Budget Strategy, the final decision on the budget envelope occurs without further consultations with ministries about how to align the objectives set in their budget bids against the revised budget envelope. Thus, there is little connection between the development of ministry Organisational Development Plans and financial plans, which has flow-on effects for the development of the state budget.

The introduction of the State Budget Strategy, linked to ministry Organisational Development Plans, has gone some way to strengthening the connection between government strategy and financing. However, there is further scope to increase linkages between strategic and budget frameworks, which will strengthen the government's capacity for resource flexibility. In some ministries, it appears that the operational plan drives the preparation of the budget bid, but this may not be the case for all entities. Organisational Operational Plans and the budget bid should complement each other. However, the link is tenuous, since the Organisational Operational Plans are classified on a programme basis (along the lines of the Organisational Development Plans) whereas the budget is not; as a result, only the ministerial totals match. Furthermore, the budget law contains only appropriations for the budget year, whereas the figures in the Organisational Operational Plans, which are published as part of the explanatory notes with the budget, contain multi-annual estimates as well. As highlighted in the OECD's 2008 budget review of Estonia, the link between the programme-based figures of the operational plans and appropriations is difficult to understand for the *Riigikogu*, as well as the broader public (OECD, 2008a).

The effect of the global financial and economic crisis has helped to strengthen linkages between strategic planning and the budget in Estonia. Prior to the crisis, the Ministry of Finance tended to align budgetary outcomes with those used for the disbursement of EU Structural Funds. Since the crisis, the budget strategies have tried to focus more on funding by policy fields rather than by costs identified by line ministries, which were set to ministerial goals. Despite this effort, there is an acknowledgement of the need for further alignment between strategy and the budget framework for the different policy fields, so that financing over the four years is identified, transparent and linked directly to the achievement of policy goals and commitments made by the government. Given this, the Ministry of Finance has begun preliminary work, as part of a broader reform proposal of budget and performance management, to better enable alignment of strategic planning with the budget.

Many governments struggle to create meaningful linkages between their strategic planning and budgetary frameworks. For example, Finland has one of the most comprehensive budget and performance management systems in the world, but has also struggled with a disconnect between the preparation of its Government Programme and budget impacts (OCED, 2010f). However, the importance of strengthening connections between strategic planning and budget frameworks, when used in conjunction with an effective performance budgeting system, helps to provide the capacity to track government spending against the achievement of policy outcomes. Without a clear understanding of where public finances are spent, it becomes difficult for government to move resources as priorities change without understanding the impacts to programme outcomes of doing so.

Estonia should look to implement measures to strengthen linkages between strategic planning and budget frameworks, to provide a foundation on which to inform government decision making regarding the use of the public's resources. Developing a long-term vision document setting forth the strategic vision for the country, as discussed in the first section of this chapter, would help to set a starting point from which all other strategic and fiscal planning should flow – such as by developing long-term plans for government outcome areas which are linked to a shared vision document. In order to gain coherence between strategic and fiscal planning, such longer-term outcome plans would need to be linked to a strategy which outlines the government's programme and which is approved for each electoral period. This should form the basis for the development of lower-level strategies outlining government programmes against planned resources and detailed in the annual state budget document. These documents should be reviewed and updated based on the newly prepared electoral-term government strategy and implemented through annual ministry outcome/action plans.

Any change to existing arrangements would require the public administration to develop a business case (see Box 5.7) – which outlines the benefits of linkages between strategic planning and budgeting frameworks, details deliverables, and includes realistic implementation time frames, risk assessment, training schedules, costs and assumptions – for agreement by the government. It should carefully explain the existing process and the proposed replacement process and the expectations of the *Riigikogu*, government, senior management, the Ministry of Finance, the Government Office, financial management and strategic planning units in ministries, and general staff. Given the importance of such a change, it is further suggested that a clear implementation plan with a communications strategy be developed for the roll-out, and for politicians and senior management, to show the importance of linkages between strategic planning and budget frameworks in decision making; additionally, training could be provided to familiarise financial management and strategic planning unit staff with each other's work to create linkages within ministries.

Implementing performance budgeting to enhance budgetary decision making

Lingering impacts of the global financial and economic crisis, and demands by citizens, are placing increasing pressure on governments to show that they are providing value for money in the use of public finances. Governments are under pressure to improve public sector performance while containing expenditure growth. While factors such as ageing populations and increasing healthcare and pension costs add to budgetary pressures, citizens are demanding that governments be made more accountable for what they achieve with taxpayers' money. Providing information about public sector performance can satisfy

the public's need to know, and can also serve as a useful tool for governments to evaluate their performance. On the one hand, performance budgeting is the mechanism by which strategic vision is translated into programme spending via commonly agreed performance objectives and indicators, thereby facilitating the linkages between strategy and budget (as described in the previous section). It also provides evidence on the impact of cuts and spending re-allocations, thus supporting better re-allocation decisions (as will be described in the next sections on evidence-based decision making).

Over the past 20 years, the majority of OECD governments have sought to shift the emphasis of budgeting and management away from inputs towards a focus on results, measured in the form of outputs and/or outcomes. While the content, pace and method of implementation of these reforms varies across countries and over time, they share a renewed focus on measurable results. The majority of governments in OECD countries use performance information as a means to help improve expenditure control, as well as public sector efficiency and performance.

Performance information in the budget process involves more than the development of performance information; it also includes the use of this information in the budget process and in resource allocation (OECD, 2007d). The introduction of performance budgeting has been linked to broader efforts to improve expenditure control, as well as public sector efficiency and performance. Performance information in the budget process can be used to gain insight into how different programmes contribute to the achievement of the executive's policies and priorities. Depending on the type of performance information captured, it can also help to explain why some programmes work better than others and whether they represent value-for-money. Used in policy and budget formulation, this information can help to design better programmes.

The OECD has defined performance budgeting as a form of budgeting that relates funds allocated to measureable results (see Box 5.5) (OECD, 2007b). Performance information – measures, targets and evaluation – enables governments to drive, monitor and assess progress towards achieving their policy and programme goals. For performance information to be useful to the central government, an appropriate system to monitor and evaluate performance is required. Irrespective of the type of performance information, a consensus exists that any information captured should be specific, measurable, attainable, relevant and time-bound in order to be useful for public managers and decision makers.

- *Performance measures* – measures of inputs, processes, outputs and outcomes used to assess the economy, efficiency and effectiveness of government programmes. They may be quantitative or qualitative variables for measuring the value of government interventions.
- *Performance targets* – specific desired outputs or outcomes for government programmes. Well-designed targets can help demonstrate the link between specific outputs and larger outcome goals that are longer term and that involve many actors, behaviours, activities and processes.
- *Evaluation reports – ex post* (retrospective) analysis of a policy and/or programme to assess how successful it has been and what lessons can be learned for the future.

Elements of programme and performance budgeting have been present in Estonia since 2003 and became official requirements in 2006 as part of the strategic planning system, in an effort to strengthen the expenditure prioritisation mechanism. This required ministries to present their budget bids as Organisational Development Plans based on programmes ("activities" and "measures", *i.e.,* groups of activities), with four-year expenditure projections

Box 5.5. **Performance budgeting**

There is no single agreed standard definition of performance budgeting. A variety of terms and definitions are incorporated under the label of performance budgeting: budgeting for results, performance-based budgeting and performance funding. Given this, the OECD has developed the following categories of performance budgeting:

Presentational – Performance information is presented in budgeting documents or other government documents. This information can be performance targets or performance results. In this category, performance information is included as background information for the purposes of accountability and dialogue with legislators and citizens on public policy issues and government direction. There is no link between performance and funding. The information does not play a role in decision making on allocations, nor is it intended to do so.

Performance-informed budgeting – Resources and performance information are indirectly related, whether in terms of proposed future performance or performance results. Indirect linkage implies that performance information is being used in the budget decision-making process, but does not necessarily determine the amount of resources allocated. In this case, formal performance information is being used alongside other information pertaining to macro restrictions on fiscal policy and political and policy prioritis. There is, however, no automatic or mechanical linkage between performance targets or results and funding. Performance information is important, but it is not absolute and does not have a predefined weight in the decisions.

Direct/formula performance budgeting – Resources are directly and explicitly allocated to units of performance, generally outputs. Appropriations can thus be based on a formula/contract with specific performance or activity indicators. Funding is directly based on results achieved. This form of performance budgeting is used only in specific sectors in a limited number of OECD countries. An example in higher education is that the number of students who graduated with a Masters' degree would release funding for the university that ran the programme in the preceding year. In this form of performance budgeting, there is a formula for systematically providing funding rewards or penalties on the basis of results produced.

Performance budgeting categories

Type	Linkage between performance information and funding	Planned or actual performance	Main purpose in the budget process
Presentational	No link	Performance targets and/or performance results	Accountability
Performance-informed budgeting	Loose/indirect link	Performance targets and/or performance results	Planning and/or accountability
Direct/formula performance budgeting	Tight/direct link	Performance results	Resource allocation and accountability

Source: OECD (2007), *Performance Budgeting in OECD Countries*, OECD, Paris.

(the budget year plus three out-years) which distinguish existing policy from proposed new initiatives. This serves as the basis for the preparation by the Ministry of Finance of whole-of-government four-year projections, which are presented to the *Riigikogu* in the annual budget and State Budget Strategy (International Monetary Fund, 2009). Despite this, performance budgeting is not yet operational in Estonia to the extent seen in many other

OECD countries. Budgeting and decision making are based on inputs rather than outputs or performance-based criteria. A lack of linkages between strategic plans and the budget means that strategic objectives are not linked directly to finances, thus making it difficult to track spending or ensure transparency of allocated funds. In addition, it is difficult to link plans to the budget when the plans do not employ the same performance indicator – there is little, if any, real performance information collected, and this is not integrated with financial information into the budget process.

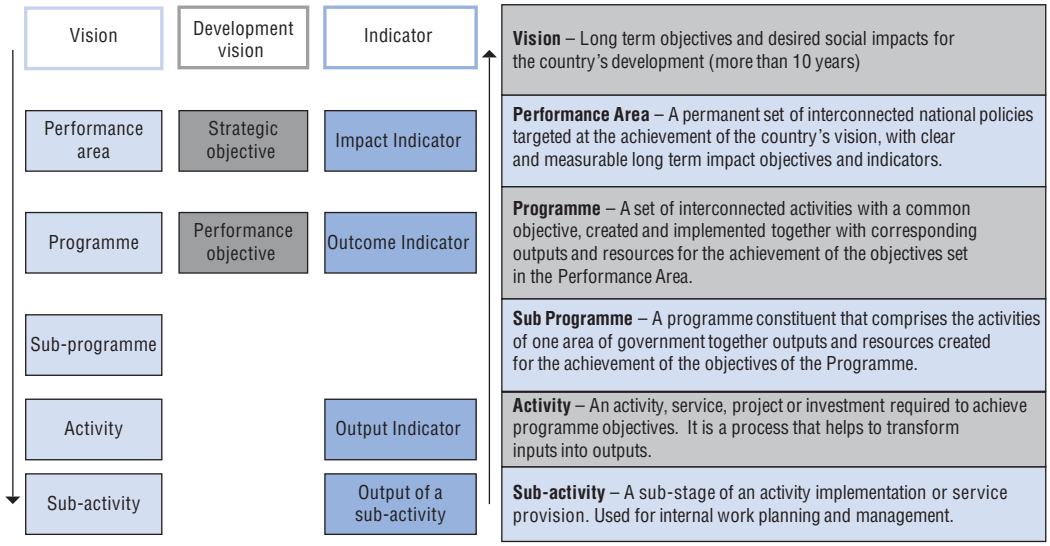
The Ministry of Finance is aware of the benefits of performance budgeting and has been undertaking preparatory work to develop a proposal for a performance and programme budgeting system in Estonia's state public administration. As part of this proposal, which is yet to be agreed by government, the Ministry of Finance is considering a programme budgeting system, where the planned costs, revenue, investments and financing transactions in the Government Strategy and annual state budget would be presented on a programme basis. The budget would contain expected outcome targets for each organisation that could be linked back to long-term strategic plans provided by ministries (objectives which would not generally change from year to year). Individual programme budgets would then provide output and outcome targets at the programme level in support of overall objectives, and would be drafted based on actual costs related to the achievement of those objectives (thus differentiating between direct and indirect programme costs).

The provisional proposals under discussion for establishing a performance and programme budgeting system, as understood by the OECD, seem to be broadly in line with international good practice in this area. The OECD would support implementing such an approach in Estonia's state public administration. The critical issue, however, is how to roll out and implement such a proposal so that it has a real impact on the quality and coherence of decision making in the State administration, and so that it can support broader efforts for the Estonian public administration to adopt a single government approach.

In developing a performance and programme budgeting system, a critical first stage of the process is to the define performance areas which are to be used for strategic and budget planning and measurement. To be effective, the definition of performance areas needs to be undertaken in parallel with the development of a hierarchy of strategic documents, which should involve the prioritisation of strategic objectives (an example of a hierarchy of performance management levels used to form strategic objectives is shown in Figure 5.5). As discussed previously, the prioritisation of strategic objectives and mapping to performance areas should be undertaken at the political level to ensure appropriate buy-in to set objectives for measurement.

Over two-thirds of OECD countries now include non-financial performance information in their budget documents, but this does not mean that it is being used to help make budget decisions. For that to happen, the performance information has to be integrated into the budget process (OECD, 2008f). However, integrating performance information into public management and budgeting is not primarily a technical problem that can be left to "experts" such as performance measures and evaluators. Rather, an evidence-based focus requires significant, and often fundamental, changes in how the public sector is managed and how public sector organisations go about their business of delivering programmes and services to citizens. It requires significant changes to all aspects of managing, from operational management to personnel assessment to strategic planning to budgeting; and it usually requires cultural change, whereby performance

Figure 5.5. **Hierarchy of performance management levels used to form strategic objectives**



Source: Adapted from information provided by the Ministry of Finance of the Republic of Estonia, and Praxis Centre for Policy Studies, Tallinn, 2010.

information becomes valued as essential to good management (OECD, 2009h). Estonia should also be mindful that other OECD countries have reported taking at least four to five years of consistent effort to fully implement performance budgeting and integrate it into their budgeting system (OECD, 2009h).

Ideally, the effectiveness and performance of policies and programmes should be evaluated on a regular basis, and this information incorporated into the budget decision-making process. The use of value-for-money and programme reviews to assess the continued usefulness and relevance of programmes and of government spending can help to improve the overall quality of performance information in the budget process. However, care should be taken that the application of performance budgeting information is used to inform decision making, rather than to determine it. Thought will need to be given as to how performance budgeting information would be integrated into the annual budget process and how it will be used, *e.g.,* formal and non-formal mechanisms for inclusion in budget negotiations.

Interviews with officials in the public administration indicated that there is difficulty in linking strategic plans to the budget, as the plans do not employ the same performance indicators. The implementation of performance budgeting would need to ensure that there is a consistent methodology used across the public administration for setting performance indicators and targets, and that this be used across strategic planning, programme management and budgeting and performance reporting. This will require the development of a "Better Practice Guide" for use throughout the public administration. (Countries such as Australia, the United States, Canada, Denmark and the United Kingdom have good practices for reporting performance information to the public.)

Successful implementation of performance budgeting would also require Estonia to increase capacity in all areas for the preparation and use of performance information in the budget process. This includes financial management staff in ministries, the budget area within the Ministry of Finance, senior management in ministries, and ministers.

Utilising performance budgeting as a decision rule requires at least the following capabilities: *a)* the government would need information and expertise to disaggregate activities or outputs into standardised units; *b)* it would then need to be able to allocate costs to these units; and *c)* be able to acquire capacity to measure results contributed by each unit (OECD, 2007e).

Capacity and capability to undertake and understand performance budgeting need to be established in all corners of the public administration and by government decision makers. This will be a critical ingredient to gaining cultural change and to the successful implementation and embedding of any performance budgeting reform. In addition, the use of performance information will provide further incentive for planning staff to develop their own capabilities and to improve the quality and depth of their work. Currently, while results-based information is submitted as part of the budget, it is not used – which decreases the motivation of staff to develop good indicators and to give this information to the *Riigikogu*. There is a need to create the feeling that something actually changes based on the provision of performance information, thereby establishing a virtuous circle in which performance information, strategic planning, programme knowledge and staff commitment are all improved.

Aware of the importance of growing capacity and capability for undertaking performance budgeting, the Ministry of Finance has been undertaking pilots as part of preliminary work to develop a broader proposal to implement performance budging in the state administration. As a tool to help those undertaking the pilot projects, the Ministry of Finance developed a wiki-site to facilitate the sharing of experiences and solutions among actors, allowing them to interact and learn through communities of practice. Participating staff are able to post questions, suggestions and lessons on the site to share with their colleagues in other pilot sites. This enables users to work and learn among themselves without needing to rely on direction from the Ministry of Finance. Such a forum helps staff to take ownership for their own learning rather than passively relying on the Ministry of Finance. It helps them to build the necessary skills, while also encouraging dialogue and the development of relationships and networks.

Should it continue down a path to implement a performance and programme budgeting system, Estonia would need to prepare itself to be realistic regarding the implementation of such a system and the benefits that such information would provide. The introduction of performance budgeting would need political buy-in and support to ensure that: *a)* the system can be implemented; and *b)* information collected through performance budgeting is actually used in an appropriate manner. It would also require linkages to the implementation of personal/individual performance management to ensure the accountability of performance outcomes. Estonia should consider sequencing performance management reforms to include the implementation of a whole-of-administration performance management system in the future, to ensure that the benefits of a performance budgeting system can be fully realised.

Furthermore, to be successful in implementing a performance and programme budgeting system, Estonia would need to:

- Gain political buy-in and support by developing a coherent business case outlining the weaknesses of the existing budgeting system and how introducing a performance budgeting system will address these. Obtain agreement from the Cabinet and have a plan for the implementation approved by the official Government Session.
- Integrate performance information into public management and budgeting processes.

- Develop an implementation plan with a realistic roll-out timeframe, ideally over five years.
- Develop and implement a communications and training strategy for politicians, senior management, middle management, financial management units, and Ministry of Finance budget staff.
- Evaluate the effectiveness and performance of policies and programmes on a regular basis – through the use of value-for-money and programme reviews.
- Develop a process for the use of performance budgeting information to inform decision making (rather than determine it).
- Develop a process to integrate performance budgeting information into the annual budget process and determine how it will be used.
- Include a consistent methodology for setting performance indicators and targets for use in performance budgeting and strategic planning.
- Establish a standard costing methodology of programmes for use across the public administration.
- Increase capacity in all areas in the preparation and use of performance information in the budget process, including for financial management staff in ministries, the budget area within the Ministry of Finance, and senior management in ministries and ministers.
- Parallel an individual performance management reform.

Countries which may provide useful examples for Estonia include: Australia, Canada, Denmark, the United Kingdom and the United States.

Using programme reviews to maximise budget resources through re-prioritisation and re-allocation

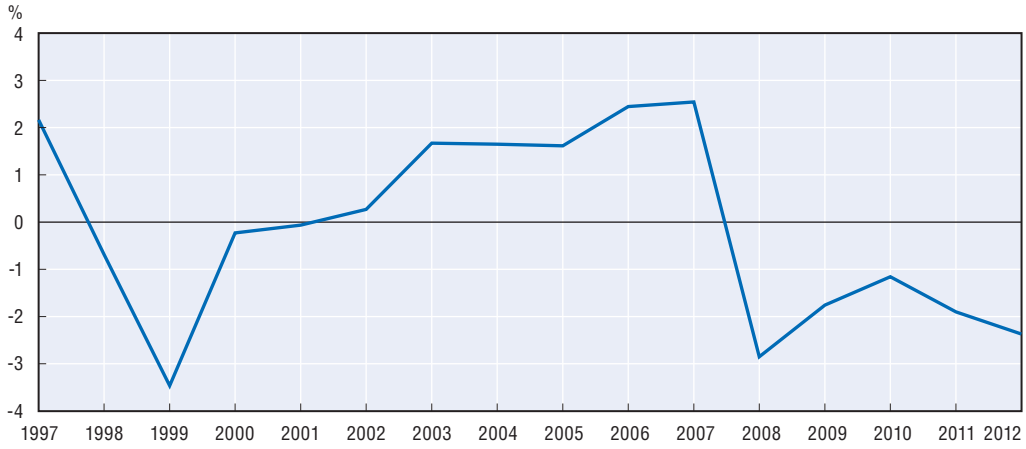
Budgetary policy in Estonia has always aimed at a balanced general government sector over the medium term (Republic of Estonia, 2009b). However, in order to alleviate the economic downturn and stimulate entrepreneurship, the budget may remain in deficit for a short period of time (at least until 2012). Between 2002 and the onset of the financial crisis, Estonia has always had a general government surplus, due to strong and larger-than-expected growth (Figure 5.6). In the period 2003-05, the windfalls amounted to slightly more than 2% of GDP, in 2006 to almost 4%, and in 2007 to slightly more than 0.5% (Republic of Estonia, 2007c). This position changed as a result of the global financial and economic crisis, and the budget slipped into deficit in 2008 (2.7%), with proceeding deficits of 1.7% in 2009 (Eurostat);[3] the forecast general government budget deficit for 2010 is 1.2% of GDP (OECD, 2010l). The forecast deficit for 2011 is 1.9% of GDP (OECD, 2010l).

The OECD's 2008 budget review of Estonia (OECD, 2008a) noted that firm ceilings had allowed line ministries to "get used to good times" and to expect additional funding to be made available during the finalisation of the annual budget. During the interviews with officials for this review, it was noted that after having been through a strong period of growth, ministries found it difficult to adjust to reduced spending limits during and after the global financial and economic crisis, where new spending had to be balanced by budget offsets.

The impact of the global financial and economic crisis saw the growing spending budgets (as opposed to offset budgets) curbed for the first time since re-independence. Demographic trends are putting further pressure on social spending, which is also straining existing resources. In a small economy, review of government expenses is necessary to ensure that the most is being gained from the use of public finances, which must be

Figure 5.6. **General government deficit/surplus**

Net lending (+)/net borrowing (–), as % of GDP



Note: 2010 and 2011 data is forecasted; sourced from the Ministry of Finance, Estonia.

Source: Eurostat Databases (2010).

re-allocated if it is not. The use of programme/policy reviews is an excellent tool for helping governments to identify poor-performing spending areas and free up resources for re-allocation to priority areas. Policy and programme evaluation provides governments the ability to map spending to effectiveness outcomes and helps them to provide necessary insight when re-prioritising and re-allocating government expenditure. Developing a culture of regular review makes it much easier to increase the flexibility of financial resources to target areas of need, but also has the impact of instilling a performance mindset. The use of management and reporting information along with performance reviews helps with the re-prioritisation and re-allocation of financial resources.

There is significant scope for efficiencies to be gained by undertaking programme/policy reviews to enable budget reprioritisation. Excluding activities during the recent global financial and economic crisis, budget re-prioritisation and re-allocation has not been a common feature in the Estonian budget context. Due to a strong period of growth and budget surpluses, ministries were used to increasing programme spending via supplementary budgets (OECD, 2008a). Thus, while at the macro budgetary level mechanisms are available for re-prioritisation and re-allocation of the budget, these were not tested on a large scale until the onset of the global financial and economic crisis.

In Estonia, the two most common ways to alter the budget during a financial year is through the use of supplementary budgets and budget amendments. On the basis of a proposal by government, the *Riigikogu* may adopt a supplementary budget during the budget year. Supplementary budget laws are allowed by Article 43 of the *State Budget Act* and are required for all changes that affect the level of total expenditure. Prior to the global financial and economic crisis, supplementary budgets were adopted annually and always involved an increase in total expenditures. However, during 2009, the *Riigikogu* passed two supplementary budgets which focused on measures to increase revenue (such as increases to the VAT) and initiatives to curb spending.

Article 116 of the Constitution restricts the amendment powers of Parliament. Proposed amendments to the budget that "require a decrease in income, an increase in expenditures, or a re-distribution of expenditures as prescribed in the draft national budget, must be

accompanied by the necessary financial calculations, prepared by the indicators, which indicate the sources of income to cover the proposed expenditures" (OECD, 2008a). In contrast to supplementary budget laws, amendments do not involve a change in total expenditure, but a re-allocation of funds. In order to initiate an amendment, the government must submit a draft budget amendment law to the *Riigikogu* no later than two months before the end of the budget year. Amendments require the specification of compensation for any increase of a line item. Prior to the global financial and economic crisis, amendments to budget laws were made within the supplementary budget laws (OECD, 2008a).

The budget rules are such that, apart from measures requiring Parliamentary approval, the government can make re-allocations between spending limits as specified after the adoption of the budget law. This type of re-allocation can take place up to four times a year. At the micro budget level, ministries are responsible for executing the budget allocated to their governing area according to the law (OECD, 2008d) – thus, within defined budget allocations. At the agency level, there is budget flexibility for operational allocations (such as staffing), but not for administrative allocations *(e.g.,* the delivery of programmes and services). At the whole-of-government level, there is no ability to divert resources among sectors (from one ministerial sector to another) without going through a Parliamentary approval process.

It was reported to the OECD that agencies have internal budget flexibility, allowing personnel to be moved depending on service demand (from one policy area to another). But there is no flexibility at the whole-of-government level, as it is politically impossible to divert resources between ministries. Objective monitoring of demand and need at the whole-of-government level would help to make a case for flexibility at this level.

There is currently no prioritisation of programmes and services in the Estonian budget. Doing this would require a review of all services being provided to the public. It can be argued that this may have occurred during the global financial and economic crisis, but the review was still *ad hoc* and lacked a systematic and comparable methodology. Given the size of Estonia's budget, a regular review on a biennial basis (to help limit additional burden) would provide the government with a better overview of activities and spending. The review would need to be undertaken from a position of high authority, and its results would need to be directly linked into the budget process and subject to Parliamentary approval.

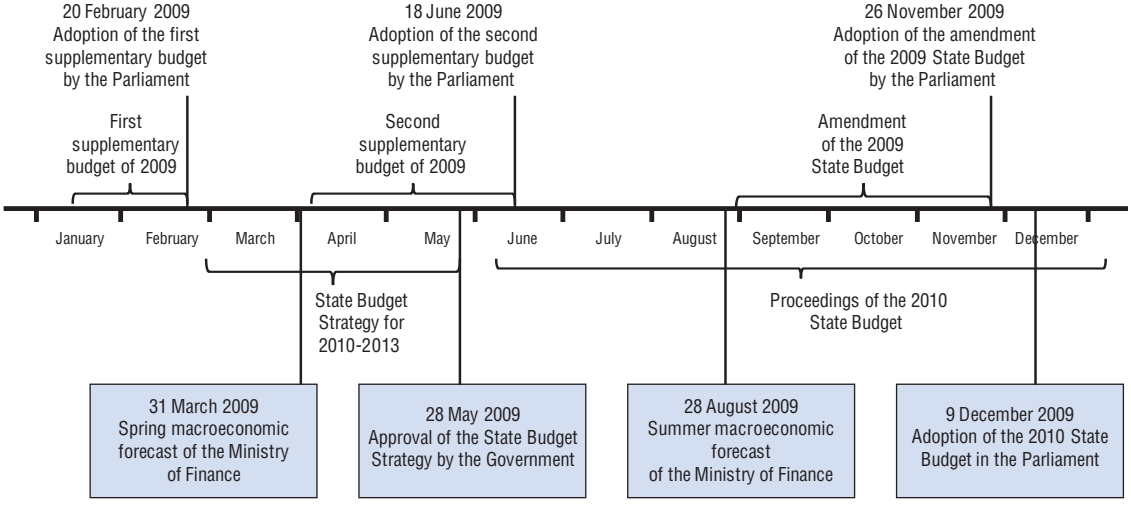
Without programme/policy review, it becomes difficult to re-prioritise programmes and services and to re-allocate funding. In the Estonian context, there is also a limited ability within the current budget framework to re-allocate funding between policy areas without going to the *Riigikogu*. Budget flexibility will become more important post-global financial and economic crisis in an environment of reduced spending, as attempts are made to bring the budget back into surplus. In addition, without regular budget reviews, it will become increasingly difficult to re-prioritise programmes and services and to re-allocate funding during "business as usual periods" (in a non-crisis environment).

Its response to the global financial and economic crisis is a good example of Estonia's ability to move resources in response to a crisis situation. Towards the end of 2007, Estonian authorities faced alarming signs of an overheating economy, almost a year before it was struck by the global financial crisis. Though the shift to an open-market economy was fruitful, it was not without risk. Fuelled in part by the end of a credit boom, the Estonian economy began to soften towards the end of 2007. As internal demand started to slow at this time, Estonian authorities started designing policy measures aimed at

circumventing the impact of a potential internal recession. While difficult at the time and though the policy measures managed only to minimise the impact of the recession, it placed Estonia in a relatively favourable position when the country was hit by the global financial crisis a year later, as they had already started implementing policies aimed at counterbalancing internal economic slow-down. Estonian authorities were therefore in a good position to respond to the global financial crisis by further improving and consolidating measures already underway.

In 2008, as the global financial crisis spread to the real economy, and in response to an expanding fiscal gap, the Estonian government revised the 2009 budget (see Figure 5.7). Three supplementary budgets representing 9.3% of GDP were passed in 2009, of which approximately one-half concerned expenditure, including decreases in social benefits, consolidation of public functions, and a half-percentage point reduction in the rate of residential income tax re-distributed to municipalities. Increases were also made to VAT and excise duties. Additional justification for fiscal consolidation came from EMU entry criteria and, particularly in the second half of 2009, the government also enjoyed popular support based on the public perception that cuts were necessary. In 2009, Estonia's public finances were in a significantly strong position compared to most OECD countries, as the overall public budget deficit stood at 1.7% of GDP and public debt represented only 7.2% of GDP (see Figure 5.8). In the first six months of 2010, goods exports had increased by 22% on an annual basis, buoyed by rising external demand (OECD, 2010l).

Figure 5.7. **Budgetary process in 2009**

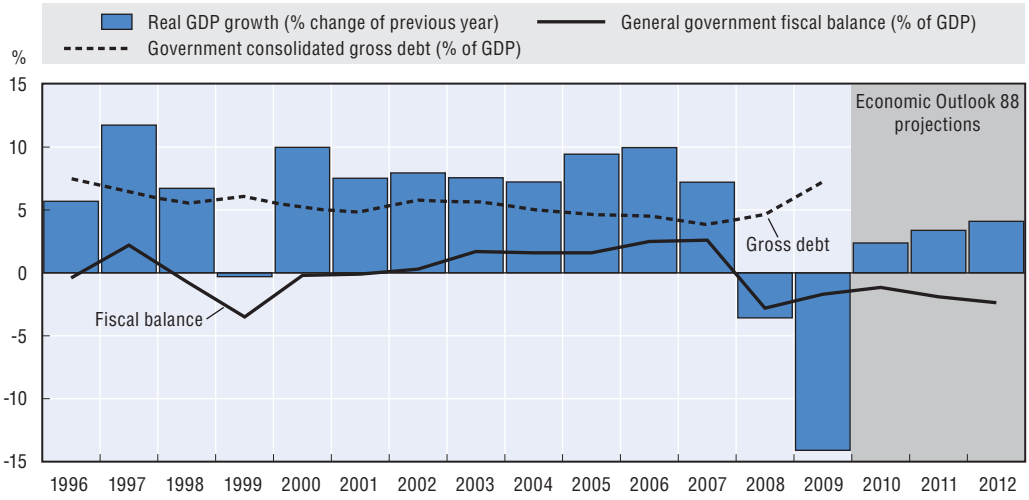


Source: Ministry of Finance (2010), *Public Service Yearbook 2009,* Ministry of Finance of the Republic of Estonia, Tallinn.

Estonia's economy recovered moderately in 2010. Though inflation returned slightly sooner than expected and unemployment remains high, the economy is forecasted to gain momentum in 2011, when growth rates are expected to reach 4%. The government is aiming to return to a balanced budget by 2013.

The economic circumstances presented in the lead up to and during the global financial and economic crisis highlighted the need for more accurate planning and realistic forecasting of revenue and expenditure on all stages of planning and in terms of all budgetary measures (a critical part of achieving resource flexibility). To achieve this, the

Figure 5.8. **Real GDP growth, fiscal balance and consolidated gross debt, 1996-2012**



Source: OECD (2010) *Statistical Database*; OECD (2010), *Economic Outlook 88*, OECD, Paris.

Ministry of Finance launched a more regular and detailed monitoring process in the beginning of 2009. The process was adapted to the changing economic circumstances, and provided strong support for the decision-making process to manage the budget. The Ministry of Finance monitored revenue and expenditure of government sector institutions on a monthly basis. This provided substantially more information about the implementation of the state budget and highlighted the need to improve various processes, systems, methodologies and to amend legal acts (Ministry of Finance, 2010a).

There is awareness within the Ministry of Finance that the global financial and economic crisis has highlighted processes of financial planning and budgeting, and of supporting systems, and that these must enable greater flexibility to allow for adaptability in changing circumstances. In interviews with the OECD, officials noted that improving the sustainability of the budget requires the availability of high-quality information on different management levels at the right time. To achieve this, the Ministry of Finance is seeking to improve the efficiency and methodologies of the state financial management process, and to consider measures for drafting the state budget strategies and state budget that would allow more efficient provision of public services through optimisation of the state structure and more considered implementation of budgetary resources. It noted that the public administration must be able to focus on the important, to quickly identify the relevant connections and, if necessary, to learn quickly and adapt work methods (Ministry of Finance, 2010a).

Due to its ability to re-prioritise and re-deploy its resources leading into and during the global financial crisis, Estonia's economy survived the global financial crisis far better than some other OECD countries. This example shows that when a crisis situation confronts it, Estonia has the ability for resource flexibility, albeit on a grand scale. There are valuable lessons for Estonia to learn from this experience and adapt to its business-as-usual budget processes, as well as for anticipating and responding to similar circumstances in the future.

Enhancing financial reporting to better track government revenue and expenditure

The production and use of appropriate management information from budget and accounting systems is critical for informing governments and their public administrations

on the status of the budget and the use of resources. Appropriate and timely management information is essential to show governments and public administrations a fuller picture of the budgetary position when looking to move resources to changing priorities as needed. This information plays a crucial role in informing government decision making about the allocation of resources within and between programmes, justifying existing budget allocations or cutting them, managing programmes and making changes, as well as setting targets for the next fiscal year.

In addition to the use of performance information as part of budgetary decision making, information extracted from accounting systems provides another layer of information to inform decision making, as well as for audit control purposes. Accounting reports and audit practices and procedures support the accountability, *ex post* scrutiny and improvement of the management of public funds by the executive, ministries and agencies. Together with increased public interest in transparency of government operations, these changes have increased the importance of accountability to maintain fiscal discipline and ensure the approved budget is implemented in accordance with programme design and intent.

Government accounting systems are used to track revenue, commitments, payments, arrears, liabilities and assets. The accounting base may be cash, accrual, or some combination of the two. Since 2004, Estonia's state administration has operated a full IPSAS-based (International Public Sector Accounting Standards) accrual accounting system throughout the general government sector. The system provides data on assets, liabilities, commitments and payments, and provides a sufficient basis for internal audit (OECD, 2008d). The Ministry of Finance publishes quarterly financial statements which provide fairly detailed data on the financial accounts of general government four months after the reporting period. Furthermore, the Ministry of Finance publishes a consolidated annual financial report for general government that includes the budget execution report of central government. The annual report must be submitted to the National Audit Office before 30 June. Both the quarterly reports and the annual reports are based on the data provided from the accounting units and reconciled with data from the Treasury payment system. The reports are published on the Ministry of Finance website (OECD, 2008d).

The Estonian state administration struggles to utilise all the management information that is collected and to incorporate it into decision making at the political and administrative levels. In a step towards addressing this problem, the government has approved the implementation of the Shared Support Services project, which will centralise all financial bookkeeping and accounting systems across the state administration to standardise the collection and reporting of financial information, and to make this information available in a central repository so that it can be more conveniently used by government in decision making. Despite the implementation of the Shared Support Services project, the Ministry of Finance is convinced that financial data would be better used for budgetary decision making if there were a move towards accrual budgeting, operating in parallel with accrual accounting. Estonia currently operates a full accrual accounting system with a cash-based budget (see Box 5.6). The government has yet to agree to the implementation of accrual budgeting, but the Ministry of Finance is running pilot projects and plans to run an accrual budget alongside the cash budget in 2011.

The Ministry of Finance has indicated that accrual budgeting is necessary to support proposed performance budgeting changes, as it will enable the actual cost of activities to be budgeted, as well as to treat the depreciation of fixed assets as a cost that must be taken

Box 5.6. **Accrual *vs.* cash accounting and budgeting**

Accrual accounting

Accounting systems should provide a reliable basis for tracking revenues, commitments, payments, arrears, liabilities and assets. The accounting base may be cash, accrual or some combination. Cash-based systems recognise transactions when cash is received or paid; accrual based systems recognise transactions when activity generating revenues or incurring expenses takes place. Examples of differences between the two include the treatment of capital assets and their depreciation, employee pensions and retirement health benefits, and interest on government debt. On the basis of these transactions, accruals provide a broader picture of countries' financial positions. Moreover, it increases the availability of cost information to government decision-makers, facilitates the management of balance sheet items and improves accountability of budget execution. However, not all countries adopt accruals in their full form. Some countries do not capitalise physical assets within an otherwise accrual accounting basis, others incorporate specific transactions on an accrual basis in an otherwise cash accounting basis (*e.g.*, public sector pensions). Even if the accounting system is cash based, the government's accounting system should still be capable of tracking assets, liabilities and charges.

Accrual budgeting

Although accruals have been applied to government financial reporting, they may also be used as the basis for the preparation of the annual budget. Accrual budgeting has been a more controversial choice for governments. Its proponents argue that it has a number of benefits, such as ensuring consistency between the budget and financial reporting framework and improving cost awareness and management control at an operational level. While accrual budgeting does provide more comprehensive information, its increased complexity creates enormous pressure on administrative units and the government more broadly. Some countries, Australia for example, have expressed disappointment with their accrual budgeting experience. Regardless of whether accruals are used, cash information remains important in all countries to evaluate overall fiscal policy, and is the focus of media and public attention.

See Annex A for a summary of the accounting and budgeting systems operating in OECD countries.

Source: OECD (2003), "Accrual Accounting and Budgeting: Key Issues and Recent Developments", *OECD Journal on Budgeting*, Vol. 3, No. 1, OECD, Paris.

into account in planning future investments. Under a current proposal, ministries would be responsible for drafting annual programme budgets for inclusion in the State budget on an accrual basis. Cost limits would be imposed when drafting the budget as based on the Government Strategy as approved for four years.

A reported objective for adopting accruals is to improve government decision making by using this enhanced information. Accrual reforms aim to hold managers responsible for outcomes and/or outputs while reducing controls on inputs. In this context, it is expected that managers should be responsible for all costs associated with the outcomes and/or outputs produced, not just the immediate cash outlays. Only accruals allow for the capture of these full costs, thereby supporting effective and efficient decision making by managers. In short, when managers are given flexibility to manage their own resources (inputs), they need to have the necessary information to do so. The use of accruals for financial reporting would therefore appear to be more successful in member countries that have significantly reduced input controls (OECD, 2003a).

In Estonia, some ministries make better use of their financial information management reporting than others. The Ministry of Justice, for example, uses functionality within the SAP system to produce financial reports. Simply put, their accountants input more information into SAP and, as a result, are able to retrieve more and different kinds of reports than other ministries. There are currently different processes occurring across the public administration in relation to the handling of financial management information. The Shared Support Services project will see practices harmonised and reporting centralised.

Only four OECD countries run both full accrual accounting and full accrual budgeting systems – Australia, New Zealand, the United Kingdom and, more recently, Switzerland (see Annex A) (OECD, 2009g). Other countries have adopted accruals for certain types of transactions. These countries include Iceland, Sweden and the United States. All of these countries apply accrual principles to the budget differently. Some set aside money for depreciation or a capital charge. Some book all taxes due as current revenue; others recognise revenue when it is received. These and other differences indicate that accrual budgeting is still in the testing stage, and that it would be premature for all but the most avant garde countries to shift their budgets to this basis (OECD, 2007e).

The case for accrual budgeting must be made independently of arguments used in support of accrual accounting (OECD, 2007e). While it may be appropriate to run financial reporting on an accrual basis, an extension of this principle to budget statements raises critical questions that must be addressed by each country through its political-administrative machinery. The disparity between the wide application of accrual accounting and the limited implementation of accrual budgeting across OECD countries suggests that the factors which have induced governments to present their financial statements on the accrual basis are not as compelling in determining how governments go about estimating future revenue and expenditure flows in the budget (OECD, 2007e). Financial statements and budget statements serve different purposes, and the methods suitable for one may not suit the other.

There are two critical and distinguishing characteristics regarding those national governments that have implemented accrual budgeting: they are regarded as among the best-managed countries in the world; and they generally give public managers broad operating discretion. Strong management is an essential pre-condition for being able to successfully implement accrual budgeting. This is because operating on an accrual basis adds to the complexity of financial management and requires both skill and probity in valuing assets and liabilities. Operational discretion is another key pre-requisite, as it is important to enable managers to efficiently use the available resources. Without appropriate discretion, managers are likely to regard accruals only as technical entries that have no real bearing on the resources available to them for expenditure (OECD, 2007e).

The implementation of an accrual budgeting system is a complex choice for any government. While accrual budgets have a number of benefits – such as ensuring consistency between the budget and financial reporting framework, and improving cost awareness and management control at an operational level – its increased complexity creates enormous pressure on administrative units and the government more broadly. The implementation of accrual budgeting also does not guarantee the production of better reporting information. While accrual financial reporting is necessary for accrual budgeting, accrual budgeting is not necessary for accrual financial reporting. The Estonian Ministry of Finance plans to run an accrual budget alongside the cash budget for 2011 as a means to test it on a larger scale and to slowly gain support for the use of accrual budgeting. This process

should be closely monitored and evaluated to ascertain the benefits, if any, of the use of accrual budgeting information in the Estonian context. These results should be used to objectively decide if proceeding down the path of accrual budgeting will provide sufficient benefits, especially when weighed against the cost of implementation.

One reason given by officials in Estonia for moving to an accrual budgeting system was that the existing cash-based budget does not take into account accruals accounting information. Rather than focusing on implementing accrual budgeting as a means of improving reporting information, Estonia should consider improving the collection, reporting and use of its existing financial information. As noted in the OECD's budget review (OECD, 2008a), financial reporting in Estonia is accurate and timely and in accordance with international standards. In particular, it was found that the financial reporting practices score very high on transparency, as all important data are released on the website of the Ministry of Finance after only a short delay. During interviews with officials, it was suggested that budgeting and decision making are based on inputs, rather than output or performance-based information. In this case, this is not an argument for implementing accrual budgeting, but rather to focus on implementing performance budgeting (as discussed in the previous section), incorporating this into budget processes, and using it to inform decision making.

Another problem raised by officials is that as budgeting is cash based, unlike the accrual accounting system, accounts cannot be used to evaluate and check the budget. Prescribing the accrual basis for financial statements gives governments valuable insights for enhancing the formulation of budget policy. With current information on assets and liabilities, a government can more clearly assess how changes in budget policy would impact its future financial condition. But as long as the budget itself is not on the accrual basis, these insights are only analytic tools, even though they are mandated for financial reports. However, if the budget were put on an accrual basis, this would become a decision rule for estimating the receipts and expenditures expected for the next or subsequent financial periods (OECD, 2007e). The fact that many governments report but do not budget for accruals indicates a preference for treating information on assets and liabilities as aids to analysis rather than as categories for decisions in and of themselves.

It should be noted that, even when both reporting and budgeting are on the accrual basis, they may show different financial results either because officials apply different accounting rules or value things differently. For example, in 2005, the State of Queensland in Australia reported a budget surplus of approximately AUD 3 billion, but the balance sheet reported an AUD 18 billion increase in net worth. This increase was due principally to re-valuation of existing assets, not to the accumulation of additional assets during the financial year. The difference between the balance sheet and the budget is justified because one measures financial stocks and the other measures financial flows (OECD, 2007e). Should Estonia continue down the path of implementing accrual budgeting, it would need to be careful to provide a sufficient training and communications strategy to ensure that staff understand the purpose of the reform and have the specialist skills needed to implement it.

In light of this, any decision to implement a full accrual budgeting system in Estonia should not be taken lightly and should weigh implementation and ongoing operational costs against expected outcomes. Any decision should also consider options for further enhancements to the current cash-based system. If Estonia commits to introducing accrual

budgeting, then a phased implementation and/or implementation of a combination cash and accrual system should be considered. The Asian Development Bank found that the improvements achieved by the New Zealand government were primarily due to political will. It was noted that a less sophisticated system could have achieved a great deal in the presence of that political will, and an even more sophisticated system would achieve very little if the political will to use it were not present (Athukorala and Reid, 2003). If Estonia is so inclined to implement an accrual based system of budgeting, then it would be wise to first implement a strategic planning hierarchy and a performance and budgeting system. Without these reforms, an accrual budgeting system would be neither possible nor effective.

Establishing frameworks for effective decision making

The public entrusts its government with decision-making authority on its behalf, but expects that governments and their public administrations will make those decisions based on sound analysis, in the interest of the country and to ensure the most efficient and effective use of the country's resources. Developing an evidence-based decision-making culture, and working to an agreed set of decision-making guidelines, can help governments and public administrations to meet these expectations.

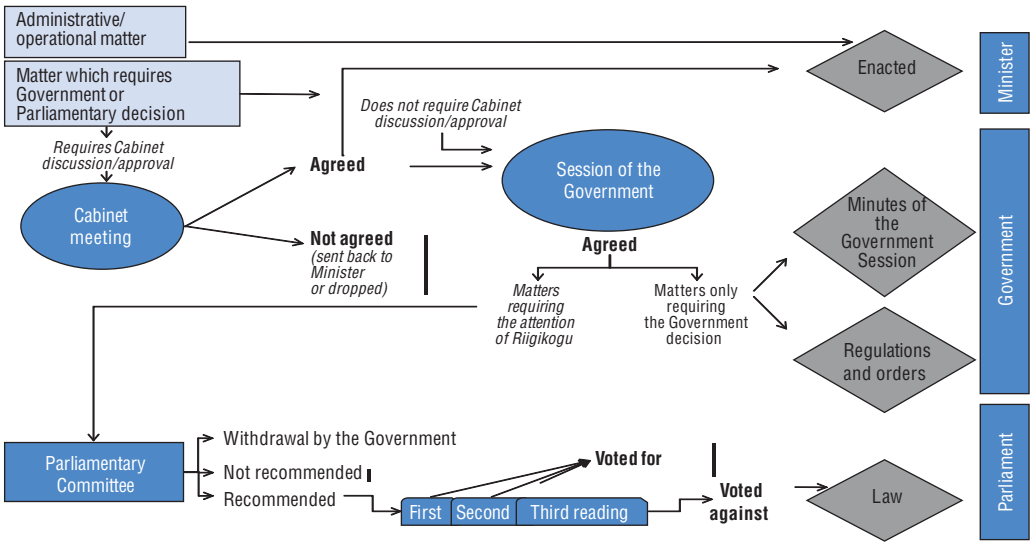
Limited resources within the state administration are currently not being used as efficiently as possible; this is the result of an absence of formal rules for the process of decision-making, in particular relating to the development of policies and legislation for matters under consideration by the Cabinet. While there are formal technical guidelines for the preparation of matters to be considered by the Cabinet, there are no formal guidelines regarding the process for the path of decision making. There are some examples where the Cabinet has not agreed to a draft bill and it has been sent back for re-work. These include proposals for a performance management system, changes to the *Public Service Act*, and legal reform (including RIA). This results in not only delays of important reforms, but also reduced policy coherence and increased workload for state officials as they draft and re-draft policy proposals without sufficient guidance or decision-making criteria.

Efficiencies can be gained by formalising decision-making guidelines

A strong government decision-making system underpins effective and well-informed public policy development and implementation. A co-ordinated and collaborative whole-of-government approach to governing is based on shared responsibility by ministers for government decision-making. In order to improve the clarity and coherence of government decision making, it is useful to examine the processes by which governments consider matters requiring government attention, including the processes by which policy proposals and decision items are: brought to the Cabinet level; discussed internally within the public administration; subject to common guidelines; and recorded once a decision is reached. These steps are integral to the smooth flow of decision making, and contribute to the efficient, effective and transparent use of the public's resources.

In Estonia, there are two main processes for decision making within the government: the *formal* meeting of the Government (Government Session), and the *informal* Cabinet meeting (Cabinet meeting) (see Figure 5.9). All government business is discussed and agreed at the formal sitting of the Government, where decisions are made public, but the discussion and reasoning supporting decisions are not made public. Matters can only be brought forward to this Government meeting with the Prime Minister's consent and if the

Figure 5.9. **Workflow of government decision making in Estonia**



matter has already received prior informal agreement from ministers, either outside of or as part of a meeting of the Cabinet.

The Cabinet is an informal body used to discuss and negotiate matters prior to their being brought forward and agreed by a meeting of Government. Decisions made at Cabinet meetings are not legally binding and are held in-confidence on a "need-to-know" basis. They are, however, where much of the policy discussion and negotiation takes place, preparing positions for official approval in the formal meeting of the Government. In many other countries, by comparison, this type of work takes place in cabinet committee meetings to work through issues before taking them to the wider cabinet for discussion and decision making. While the publication of decisions from the meeting of the Government does provide transparency of final decisions, in fact, the use of informal Cabinet meetings actually reduces the transparency of the decision-making process, making it more difficult, in some cases, for the public administration to follow up on the will of the government.

When the public administration develops new policy or legislative initiatives, the first time Cabinet ministers are involved in the process is when the full draft policy or bill is brought forward to the Cabinet. Ministers are not required to seek approval from the Cabinet before developing concepts or legislation. Currently, when the public administration wishes to develop policy or legislation, in some cases, individual ministries create concept notes which are given to the relevant minister for approval. At this stage, the concept is usually not agreed upon by the wider Cabinet. Ministries then prepare a full draft bill. The lead time on developing a draft bill is lengthy. Thus, much work is being undertaken by the public administration without a mandate from government to do so.

While concept papers are sometimes used, full drafts of policies or legislation are often developed and provided to Cabinet without it first seeing a proposal or concept paper. More often than not, the draft policy or legislation is in no condition to be agreed upon by the Cabinet and is sent back to the public administration for amendments. This is further magnified, as the public administration is not practiced in developing proposals or business cases which make a clear and compelling case to the government from which to make decisions (see Box 5.7). This points to the need for the public administration to

Box 5.7. **Definition of business case**

The term business case refers to a communicated rationale for a reform/project/change, providing the vision and outcomes to be achieved, the methodology for achieving them, a cost-benefit analysis, impact assessment, engagement strategy and evaluation framework. While commonly used and understood in public sector ICT units as a way to show expected return on investment, this concept also has broader application in for public administrations as a means to improve evidence-based decision making by:

- making criteria, expectations and assumptions explicit for new policy proposals or public sector investment plans;
- providing a basis for comparison and prioritization of competing projects or investment plans, including across sectoral areas (when using common business case methodologies);
- communicating the rationale of a project to political and administrative decision-makers; and
- providing a basis for evaluating project success.

Source: OECD (2010), *OECD Public Governance Reviews: Finland: Working Together to Sustain Success*, OECD, Paris.

improve its analysis and capability in developing business cases. Clearer criteria for the Cabinet agenda would make it easier for both sides to determine what is needed to ensure that submissions meet expectations.

In addition, as the lead time for developing a bill is lengthy, in many cases the public administration has already started to put structures in place to support the work being developed in the draft bill, even though it has yet to be agreed upon by the Cabinet and the *Riigikogu*. This leads to a lot of stopping and starting, as there is no clear strategic agreement on the business case for reform. This loss of time and resources could be avoided if ministers and the public administration first sought approval from the Cabinet on a concept paper and if the public administration consulted widely in the development phase before drafting a full bill.

Good policy rests on informed decisions, which require agreement on facts and knowledge of the opinions of those who have expertise in the subject matter. Consultation provides the means for obtaining the necessary information and views. It is an integral part of the development of a policy proposal, from the outset of that development through to the lodging of the submission. Ministers and ministries with an interest should have ample opportunity to contribute to the development of a proposal and to resolve any differences before its lodgement for consideration by the government. Consultation in the development of proposals should ensure that, as far as possible, differences are resolved in advance of the Cabinet's consideration; if resolution is not possible, differences should be identified and set out in a way that will facilitate informed decision making. Proper consultation takes time, and ample allowance should be made in the planning stages. This is especially so where there are critical dates for the Cabinet's consideration of an issue.

In Estonia, inter-ministerial consultation generally occurs late in the process, once a bill is drafted by the responsible ministry. However, when the draft bill is sent for inter-ministry consultation, it may not reach the ministerial level before it is ready for either a discussion by the Cabinet or consideration at a Government Session. In the absence of a Cabinet agreement to bring a draft bill forward, often the first time that the full group of ministers sees a draft bill is when it is sent around at the end of the development process for

consultation, before either going the Cabinet or the Government Session for an implementation decision.

A lack of consultation prior to the development of full draft policies and legislation can result in a lack of linkages between reforms, for example, between budgeting and individual performance management systems. To foster consultation in the policy development process, there should be at least three basic stages of the development of submissions: 1) exposure drafts (concepts or proposals); 2) drafts for comment; and 3) final documents for decision making. A lack of internal consultation leads to inefficient processes, where bills have to be sent back and rewritten. To ensure that all appropriate stakeholders are consulted before a matter is brought forward, ministers initiating submissions should be responsible for ensuring that the consultation necessary to enable a fully informed decision first occurs at both ministerial and official levels. It is particularly important to agree on factual matters such as costs, *i.e.,* matters that are not open to interpretation or differences of opinion that will form the basis of Cabinet discussions.

Efficiencies can be further gained by streamlining the policy decision-making process, and making expectations more explicit. In Estonia, a formal regulation (Government Regulation No. 160 of 11 June 1996) stipulates the guidelines and requirements for the submission of materials to be included on the agenda of a meeting of the Government (*i.e.,* a Government Session) and the *Parliamentary Internal Procedures Act* details the requirements for business being brought forward to the *Riigikogu* (it that this regulation has since been superseded by Government Regulation No. 10 of 13 January 2011). While a technical template provides guidance for officials on how documents should be configured, there are no formal guidelines or requirements for either the submission of material on the agenda of the informal Cabinet meetings, or stipulating when and what type of matters can be brought forward to the Cabinet. This creates a situation where there is insufficient structuring of the business discussed and agreed at the informal Cabinet meetings – which thereafter form the basis for all formal government decisions (at the meetings of the Government and then for consideration by the *Riigikogu*). The result is a multiplication of transactions, as policies and legislation are discussed and re-worked – after they have already been written.

Agreed and shared decision-making guidelines contribute to greater consistency in public policy formulation, support ministers in meeting their individual and shared responsibilities, facilitate co-ordinated and strategic policy development and enable informed decision making on all issues requiring shared determination. Estonia does not have a formalised Cabinet meeting handbook or internal government Cabinet guide to assist ministers and public officials in the preparation of matters to be dealt with at government meetings. As such, the public administration spends considerable time and resources developing policy and draft bills without the express authority of the Cabinet meeting to do so. Estonia could look to implement a formal Cabinet Handbook, similar to those used in Australia, Ireland and the United Kingdom.

Cabinet decisions have no legal weight and decisions are typically written in broad strokes rather than in detail, leading to variations in the interpretation of Cabinet decisions and questions regarding paths forward. The interpretation of Cabinet decisions is further complicated as, despite the decision of the Cabinet, it is not binding and ministers have the authority to do as he/she sees fit. As such, a minister can choose whether or not to come forward again with a proposal, modified or not. However, the Prime Minister can prevent

such matters from making the agenda of a meeting of the Government Session if all ministers have not first reached prior agreement.

Better recording of informal cabinet decisions with more detail as to what was agreed upon could create value by reducing misinterpretation and/or alternate interpretation(s) of the decision. Within Estonia's Cabinet recording system the way decisions are recorded, the level of detail and the sharing of information could be strengthened, for example, by better ensuring that officials impacted by decisions are adequately informed. This is particularly important as the Cabinet meetings are where all the discussions and decisions are made, but the proceedings are not included as part of the public record of meetings of the Government Session.

The e-Cabinet is a good example of the use of a common ICT system to support government decision making (see Box 5.8). The system is innovative and quite advanced. Estonia has received much recognition internationally for its development and use.

Box 5.8. **e-Cabinet**

In 2000, the Estonian Government began using the Information System of Government Sessions (the formal decision-making meeting of the government), known as e-Cabinet, as a tool to support government decision making. The system allows the seamless online preparation and management of documents, presentation to government for consideration, and minute-taking, all paperless.

Ministries prepare documents electronically to be discussed at the Cabinet session. These documents are transferred to the Government Office electronically through the e-Cabinet system using a digital signature. On the same day, the Government Office lists the proposed agenda items for the Cabinet session and makes these available electronically in e-Cabinet for ministers and officials. Three days before the Cabinet session, Secretaries General provide comments on the proposal to be considered at the forthcoming session. These comments are entered directly into e-Cabinet and are available for all ministers and officials to view. Two days before the Cabinet session, the Prime Minister views the proposals and decides the Cabinet agenda. One day before, the Prime Minister approves the agenda and ministers provide their opinions on the proposal for viewing in e-Cabinet. During the Cabinet meeting, ministers use e-Cabinet to view agenda items and documents, and officials record the government decision and take minutes of the meeting.

Benefits of using e-Cabinet are described as a more user- and environmentally friendly system which saves time and makes decision making more transparent. Before the introduction of e-Cabinet, Cabinet sessions took on average between four and five hours each; with e-Cabinet, sessions take between 30 and 90 minutes each.

Source: Information provided by the Government Office of the Republic of Estonia, Tallinn (2010).

More explicit rules as to what can come forward to Cabinet, and when, would further improve the efficiency of the public administration – clearer rules, clearer recording of decisions, greater clarity of what can be done and when. Currently, the Cabinet Secretariat in the Government Office is responsible for the preparation and organisation of the sessions and meetings of the Government, and the supervision of the fulfilment of tasks given to ministers by the *Riigikogu*, the Government and the Prime Minister. The Strategy Unit in the Government Office is responsible for tracking the implementation of Cabinet and Government Session decisions within the public administration. The Cabinet Secretariat would benefit from taking

a stronger role in vetting proposals, and draft policies and legislation, before they are brought forward to the Cabinet and Government Session for consideration.

An evidence-based decision-making culture can help to achieve government objectives

As a small state with limited resources, Estonia seeks to make the most of the resources it has and ensure that their use will provide the most efficient and effective return. Governments require sound evidence on both the effectiveness of outcomes and the effectiveness of implementation and delivery of policies, programmes and projects. The availability of both types of evidence is often in short supply (Davies, 2004). Evidence-based decision making is a key tool through which governments and public administrations can examine and measure the likely benefits, costs and effectiveness of their decisions. After undertaking wide consultation and research, and ensuring that all possible scenarios have been taken into consideration, governments can use this information to increase the quality and transparency of their decisions.

While evidence-based decision making exists in the Estonian public administration, it remains under-developed and under-utilised.[4] Public sector decision making in most areas tends not to use all the evidence bases available to it to drive policy decision making. This is further complicated by the lack of a framework to support an evidence-based decision-making culture within the Estonian public administration and government. For it to be useful there needs to be an analytical framework for using the information collected, such as a Regulatory Impact Assessment (RIA) process and methodology.[5]

There are significant implications for governments that do not undertake regulatory impact assessment. Impact assessment helps to improve evidence-based analysis and transparency. It also improves the understanding of impacts of government action on the benefits and costs; improves government accountability; and improves co-ordination between public policies that are inter-related. Finally, it helps to raise awareness in the community of policy proposals and their implications (OECD, 2008c).

Estonia has some way to go in order to develop and implement a fully integrated evidence-based decision-making framework. The Ministry of Justice, on its public website, notes that the impact of legislation is "virtually not analysed". There are only limited and relatively general formal obligations for ministries to explain or justify why a regulation is being enacted and, with the exception of environmental and finance laws, draft bills generally do not include robust impact assessments. While there is support in some ministries to undertake impact assessment, it is generally not supported at the political level; some leaders believe that doing so will reduce the government's ability to undertake *ad hoc* work.

The Ministry of Justice is aware of the need to incorporate impact assessment into governmental decision making and is currently preparing a proposal on regulatory impact assessment. The approval of the policy document on the development of principles of legal policy by the *Riigikogu* in January 2011 provides a solid basis on which the Ministry of Justice can prepare a concrete regulation for adoption. The aim of the Ministry of Justice's proposal is to widen the scope and use of impact assessment. It will likely provide guidelines for the use of impact assessment, but will fall short of providing tools on what methods to use. The expectation would be that ministries will be asked to prepare a short document outlining the objectives of the bill and including a broad estimation of the impact

assessment. The Ministry of Justice will vet and approve the document (it will also include assessment of the quality of the impact assessment).

Despite the recent approval of Government Regulation 10/2011 active from 1 February 2011, which gives clearer grounds for the use of impact assessment, there is still no agreed methodology for the use of Regulatory Impact Assessment (RIA) as part of the governmental decision-making processes. Estonia should therefore look to develop and systematically implement a framework for RIA in the public administration. The use of RIA requires a specific skills set, which is a combination of programme knowledge, awareness of citizen needs and impacts, and an understanding of budget impacts. It is unlikely that all of these are present in one individual, thus requiring different areas within the ministry to work together in developing the impact assessment (such as policy units, analysis units, and budget units). The implementation of RIA also requires the delivery of appropriate training to users.

Estonia could look to the success the United Kingdom has had in strengthening the use of *ex ante* impact assessment in its public administration through efforts to appropriately allocate responsibilities, such as ministerial accountability, use of economists to support the monetisation of costs and benefits, and defining areas responsible for actually undertaking impact assessments. In order to focus limited analytical capacity, Ireland provides a two-tiered RIA process in which only legislation/regulations that are significant in terms of impact or cost receive further analysis.

The key to evidence-based decision and policy making is using the knowledge produced through multiple sets of data and analysis to inform and influence policy, rather than to determine it. Effective policy design, implementation and evaluation depend on several evidentiary bases. Evidence-based decision making must draw information from appropriate sources. Ideally, this should include information coming from five areas: political; research and technical; professional and practical; citizen; and the public administration (see Box 5.9). In this way, decision makers can obtain a breadth of knowledge to appropriately and adequately inform decision making.

Estonia has relied largely on its political knowledge as an evidence base for decision making. While this is a critical driver for decision making, it should not be the only source of evidence used when considering public policy decision making. Partisan decision making is politically based and focused on persuasion and support rather than objective evidence (Head, 2008). Among those interviewed, there are some in the public administration who are concerned that analysis is provided after decisions have been made to support a partisan programme. Sometimes decisions are already made and the analysis is requested as a complement to making the policy rather than as the basis for the decision. Sometimes, there is a need to support areas because decisions have been taken and, especially if money is involved, decisions can be very difficult to change. Often decision makers want something they can do now and at a low cost, so they are not always satisfied if the answers do not correspond to their expectations. Oftentimes, politicians in Estonia are more focused on pushing through an immediate policy programme than on looking more broadly, using all information and perspectives available, to examine policy alternatives. These are familiar issues for governments the world over, and this is a complex balance to achieve in any OECD country, but, 20 years after re-independence, Estonia may now wish to see how it can broaden and re-balance its decision-making inputs in order to improve decision making.

A strong reliance on the political evidence base for decision making is reinforced by under-development of the other evidence bases available – including professional and

Box 5.9. **Key areas of knowledge for evidence-based decision making**

The five key areas of knowledge that governments should be utilising as part of an evidence-based decision-making regime are: *a)* political; *b)* research and technical; *c)* professional and practical; *d)* citizenry; and *e)* public administration:

- **Political knowledge** includes the political experience, analysis and judgement of political actors (*e.g.,* parliament, government, executive, cabinet, ministers and political staffers and their consultants).
- **Research and technical knowledge** includes the products of scientific analysis produced by universities, and research and technical institutions.
- **Professional and practical knowledge** involves information on the practical every-day issues related to policy and programme implementation, made available by professional and managerial communities, typically from the private sector.
- **Citizen knowledge** is obtained through engaging with citizens, businesses and civil society organisations.
- The **public administration** is responsible for providing its own impartial advice to government, but it also has a duty to provide analysis of the information collected from the various areas of the evidence-base.

Key areas of knowledge for evidence-based decision making

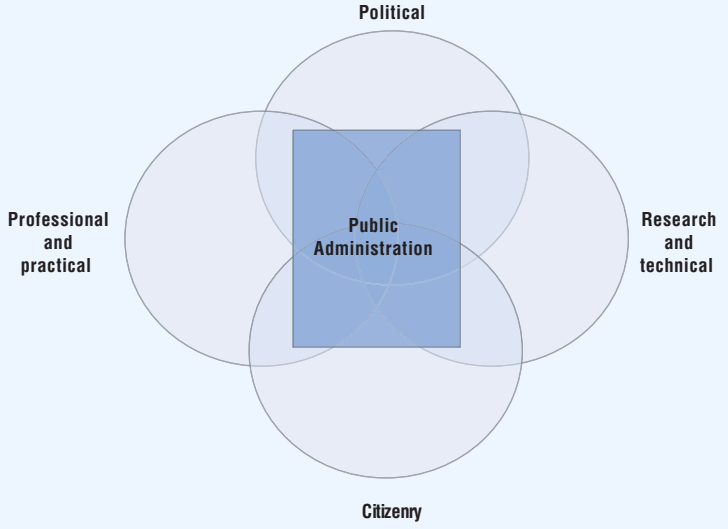


Figure adapted from work by Head, B.W. (2008).

Source: OECD (2010), *OECD Public Governance Reviews: Finland: Working Together to Sustain Success*, OECD, Paris.

practical, research and technical, citizenry, and the public administration. Further developing these other evidence bases will support increases in their use over time in government decision making.

In Estonia, professional and practical knowledge available within the business and non-government sectors is largely untapped, particularly in the non-government sector. Consultation and participation with the business sector occurs more frequently – and this may be due to a level of capacity within the business sector to organise itself and communicate at the same level with government. On the other hand, Estonia tends to rely

much more on research and technical knowledge – when it is in line or supportive of the government's agenda. However, there can be an over reliance on research and analysis when it comes from only a selection of bodies. Praxis is one such body. The Praxis Centre for Policy Studies was founded in 2000 as Estonia's first independent non-profit think tank. Its mission is to improve and contribute to the policy-making process in Estonia by conducting independent research, providing strategic counsel to policy makers and fostering public debate. While it has a history of providing research and analysis of a very high calibre for consideration by the public administration and government, it has grown to be relied upon by government. As Estonia's use of evidence-based decision making grows, the public administration could strengthen its decision-making base by broadening the set of independent research and analytical bodies that it draws from in order to provide analysis and advice to the government.

In Estonia, academic institutions are not used as strongly as in other countries, such as Finland. There is room here for further development, as well as for debate over differing opinions that should be acknowledged as part of evidence-based decision making. While in the medium-term, Estonia can look to enhance and increase the capacity for professional and practical and research and scientific evidence bases, it is critical that in the short-term, attention be given to rapidly growing the capacity and capability of the public administration to undertake analysis and foster citizen consultation and participation.

Effective decision making requires input from citizens

Citizen engagement – including civil society organisations, business, and non-government organisations – is an effective means by which governments can gain support and buy-in for their decisions, actual or planned. Citizens can also provide innovative ideas for solving policy problems or delivering services. Estonia has experienced a dramatic increase in living standards over recent years. Effective citizen consultation is critical to gaining society's agreement as to how Estonia's growing wealth should be used *(e.g.,* reducing taxes, increasing social transfers, improving services).

Estonia's public administration has been growing its capacity to engage civil society in policy development. Engaging interest groups in drafting legislation and preparing policy documents is not mandatory under Estonian law; however, elements of participatory democracy and engaging interest groups can be found in the Constitution, rules of the Government of the Republic, and guidelines for legislative drafting. A significant push in favour of engaging interest groups has come from the general regulation of European Commission structural funds, which requires engagement of social partners in preparing a national plan for financing measures.

Consultation with civil society organisations is stipulated in a government decree adopted in 1999, which provides that the explanatory letters of draft laws should also include the opinions of non-government organisations and interest groups. It is understood that the rules of the Government of Republic are currently being amended, and may include further guidelines on enhancing public participation.

The Estonian Civil Society Development Concept – a strategic document defining the mutually complementing roles of the public sector and civic initiatives, principles for their co-operation and mechanisms and priorities for shaping and implementing public polices and building up civil society in Estonia – was adopted by the *Riigikogu* in 2002. In 2005, a "Code of Good Practice on Involvement" was developed, which elaborates the key

principles that support active and meaningful participation of civil society organisations and the wider public. The Government Office has subsequently published a guide to engagement on its website which provides a public pledge regarding engagement by the public administration (see Box 5.10).

Box 5.10. **Engagement practices in Estonia**

The Government Office has published a guide to engagement (The Good Engagement Practices on its website *www.valitsus.ee/en/government/engagement-practices*), which provides guidelines on how to engage, who to engage, and the principles for engagement. The guideline, which is not legislated or mandatory, applies to administrative agencies in the preparation of strategic documents, which are defined as: drafts of laws and their amendments, or regulations and directives of the Government of the Republic, Ministers' decrees and legislation of European Union institutions and other strategic documents; documents, concepts, policies, development plans, and programmes that are important to the country's development; instruction and procedures for rendering public service; and conventions and international agreements, as well as the documents that are worked out within their framework, and that influence society. The principles for good engagement are defined by the Government Office as:

- *Clarity of the goals of engagement* – briefly and clearly state the initial assignment, expected result, and projected effect of the consultations and resolutions.
- *Engaged parties* – determine the parties with whom to consult in the given field and take their wishes, needs, and distinctive features into consideration.
- *Engagement at the early stages* – for consultation and participation, involve the parties in the preparation of the draft as early as possible and continue the engagement throughout the entire course of the process.
- *Detailed plan for engagement* – design an engagement plan that is as detailed as possible.
- *Smooth communication* – ensure that the public, interest groups, and those possibly affected by the strategic document will be informed.
- *Interim summary of the course of the engagement* – compile an interim summary of the course of the engagement, correct the particulars of the process, and inform the parties of the interim summary.
- *Announcement of the results* – inform the engaged parties of the results of the engagement. And
- *Assessment of the engagement and results* – assess the engagement and the applicability of its results.

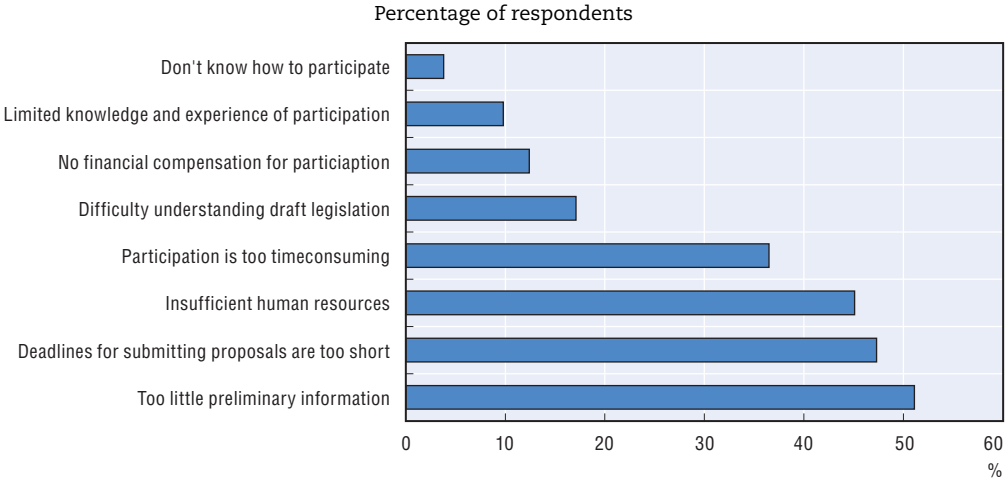
Source: Government Office (2010), *www.valitsus.ee/en/government/engagement-practices*, Republic of Estonia, Tallinn.

Despite the best efforts of the public administration, consultation between government and civil society organisations in Estonia is still being developed and embedded into the culture of every-day work. Despite the implementation of the good practice guide, 57% of officials in the state public administration surveyed indicated that there is no source or systemic basis for determining when to engage (Praxis, 2010). It was noted that the good practice guide provides ministries information on "how to" engage, but not "when" to engage. It was further said that consultation is identified in the policy development process for public administration staff, but it does not define what consultation actually means and how to do it.

A key problem is: while consultation activities are being undertaken, they tend to occur too late in the policy development process to have real effect. Public consultation usually occurs after legislation has been drafted, rather than at the concept stage. While ministries are required to consult, most often the process occurs too late for the information obtained to have any real effect or influence in the policy development process. A survey of engagement with Estonian government agencies found that while engagement practices have increased between 2004 and 2010, a greater proportion of stakeholders are still being consulted at a late stage (32% in 2004 and 47% in 2010 [Praxis, 2010]), when the policy/legislation has been developed and uploaded on to the e-Law system for external consultation.

Estonia has an online citizen consultation portal (e-Law, *www.osale.ee*) where draft legislative acts are placed for public viewing. Only those registered are able to log-on and leave remarks or proposals – usually this is provided to organisations such as NGOs, business groups, etc. Draft legislation is only provided on e-Law at the end of the drafting process. Civil society organisations, non-government organisations and unions have expressed concern to the OECD that there is limited time to comment on the drafts once they are placed on e-Law or *www.osale.ee*. They have also noted that, if they were involved in the policy/legislative process earlier, they would be more informed of the proposed changes, would have been contributing feedback/input throughout the process, and would thus be in a better position to comment once the final draft was made public. In addition, it was suggested that the timeframes provided for comment of the draft once it is loaded onto e-Law were too short for them to fully digest the content (which is written in a legal form) and to then provide a submission. This is supported by survey results, which show the key barriers to stakeholder participation with the state public administration being: too little preliminary information; too short timeframes for commenting; insufficient resources to divert to participating; and participation too time consuming (see Figure 5.10).

Figure 5.10. **Barriers to stakeholder participation with the state public administration, 2010**



Source: Praxis (2010), "Survey of Engagement in Estonian Government Agencies," presentation of Survey results, Praxis Centre for Policy Studies, Tallinn.

To balance stakeholders' perceived difficulties in engaging with the public administration, it was apparent to the OECD that there is also a difference in expectations

between what civil society and non-government organisations understand as consultation and participation and how their input and feedback will or will not be used by the public administration. The *Survey of Engagement Practices in Estonian Agencies* found that, despite feeling more engaged with and connected to the public administration, stakeholders[6] do not feel that they have actual influence as a result of that consultation (41.4% of stakeholders reported that the information they provide is "rarely" used – unchanged between 2004 and 2010).

It has been put forward in Estonia that there is a lack of transparency by the public administration as to how the proceeds of consultation are used. However, consultation does not mean that exact input or feedback will be accepted and used in its entirety, but rather that the information forms part of a large mix of ideas and evidence from which to develop policies. The public administration and government could improve the public's understanding of these issues by being more transparent as to how information is used and why a different approach may have been taken. This suggests further education on the meaning of engagement to citizens and civil society and non-government organisations, as well as to the public administration and government. Education on the purpose of engagement would facilitate a robust exchange of ideas and allow those ideas to be analysed with other evidence bases to come up with a solution or approach that, as best as possible, takes into account various views, but that is for the benefit of the country as a whole – and not just a select few.

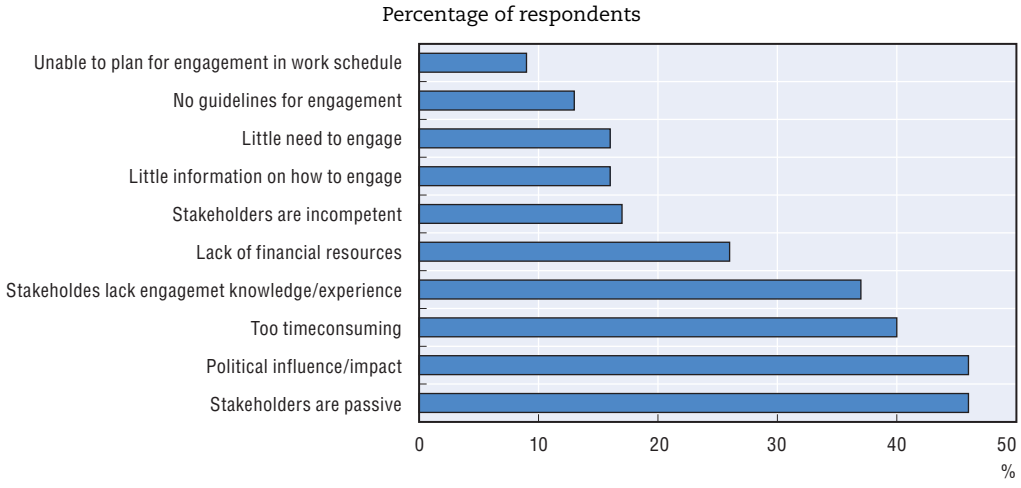
Ministries indicate that they have already undertaken a number of participation activities and do not feel the need to publicise this. However, making the consultation process public is an issue of transparency. Ministries say that they are consulting during the full policy development process and not just at the end stages, but – as they are not being transparent about this with the wider public – these activities are not seen, leading to charges that the public administration does not consult. It could be that ministries are only consulting within their already long-established networks and may need to expand their scope of consultation. These are common issues across OECD countries, and require a better understanding across the public administration of the need for and benefits of public consultation.

There are some user groups and civil society organisations which are articulate and which have some capabilities, comparative knowledge and capacity to gather data and formulate their views and express their main interests. However, generally civil society organisations, trade unions and employers associations are small and weak in Estonia. The capacity of civil society organisations in general is limited. Thus, while the government and public administration only involve civil society organisations to a limited extent, they do not have the capacity to be further involved. As such, there could be investment in building the capacity of civil society and non-government organisations to help them connect with government. That said, there are many examples of foreign aid being used to support civil society and non-government capacity building. The Foundation of Civic Society provides useful training, including also the Open Estonia Foundation. However, there is scope for more organised and robust capacity building for civil society and non-government organisations as well as unions and associations on supporting their engagement with government and the public administration. In particular, smaller organisations need help to think strategically and to involve themselves in policy making.

While stakeholders identified barriers to engaging more effectively with the public administration, the public administration is also facing obstacles to undertaking engagement

with external stakeholders. One of the key barriers identified by government agencies to undertaking stakeholder engagement is that there is not sufficient political will for consultation. It is perceived that elected officials believe they have a mandate to do what they feel is appropriate, as they were elected by the people – and thus there is no need for consultation with the public. It was highlighted that consensus building is not very common in Estonia. Some feel that the government often uses the Government Programme as a pretext for not opening up new issues for negotiation. For such an impasse to be crossed, both the public administration and government need to understand the benefits of engagement. Further barriers identified to undertaking engagement activities included the view that stakeholders are passive, that engagement was too consuming and that stakeholders lacked knowledge and experience in how to participate when approached (see Figure 5.11).

Figure 5.11. **Identified barriers to government agencies undertaking stakeholder engagement, 2010**



Source: Praxis (2010), "Survey of Engagement in Estonian Government Agencies," presentation of Survey results, Praxis Centre for Policy Studies, Tallinn.

The public administration engagement survey shows that officials find it too time consuming to undertake consultation and participation activities. Time needs to be planned for and put aside to undertake engagement activities. The public administration needs to build consultation and participation activities into the policy and legislative development process timeframes. Consultation needs to be project managed, incorporated into work timeframes, and resourced to cover the cost of consultation/participation processes. In addition, efficiencies could be achieved by co-ordinating activities among ministries – so as to "share the burden".

The key finding in relation to engagement activities in Estonia is that engagement must commence at the concept stage, before the policy or legislation is fully developed. Valuable input is being missed when consultation occurs too late to have any real effect or influence. In addition, the consultation that does occur is not in a form or manner that is effective, both to those being engaged or to the public administration. Estonia has made a lot of progress in a relatively short period, but it is now a critical time to take engagement activities to the next level, to make the activity of engagement as effective as possible, and to embed engagement into the culture of the public administration – where its benefits are recognised at all levels within the administration including at the political level.

Estonia should continue its programme of training within the public administration and with civil society organisations on engagement best practice. A challenge to consultation and engagement in Estonia is that public officials assume civil society organisations operate like a ministry and have lawyers that can read draft legislation, understand the changes and make legal proposals. Education of public officials on how to work with civil society organisations will be a critical step in making engagement a useful tool in the policy development process, as well as to addressing some of the concerns raised by these stakeholders. Given the age of the bureaucracy, it may take some time for training activities to take effect – officials need the time to learn how to consult and to learn from their mistakes. In addition, to raise awareness of the benefits of engagement, training should be expanded to include more decision makers and managers rather than just practitioners.

The scope of the "Guide to Engagement" should be widened to include examples of best practice of not just how to engage but also when to engage. In addition, there is a need to tailor engagement mechanisms based on the issue and the groups being engaged. For example, some more organised groups may prefer to engage through established tri-partite negotiations and to work to come to a genuine consensus. However, others are more capable of developing and submitting proposals directly to government.

Citizens, on the other hand, should not be expected to go to the e-Law website and comment on draft bills/legislation. This is not how individuals prefer to engage with government. To maximise their input, "people-to-people" discussions are required. There is quite a lot of information provided online by government and the public administration; however, citizens either do not realise the information is there or do not know what to do with it. The public administration needs to pay attention to providing information publically, in a form that can be digested by citizens and is likely to be accessed (here there is a difference between providing information so that it can be accessed as opposed to providing information in a manner that makes it accessible). Citizens' forums and panels seem to have worked well in the past in Estonia.

It is further suggested that a follow-up survey of engagement practices be undertaken in two to three years to monitor results and the extent to which engagement is being effective and is embedded into the culture of the public administration, and to also determine any increase in the capacity of civil society to engage and participate with the public administration and government. The scope of the survey should also be widened to gain the views of citizens and not just organised groups.

Analytical decision making requires both capacity and capability in the public administration

There is limited analytical capacity within the Estonian public administration to support key decision making. This has been observed at the political and whole-of-administration levels, sub-national level, at the management and leadership level, and at the individual level. Analytical skills capability includes the ability to identify, define and solve problems, and to make decisions based on a wide variety of information. This involves: applying logical and strategic thinking to research; gathering information from diverse sources; identifying and scrutinising the information through analysis; designing and testing innovative solutions; and using this information to develop action plans.

In Estonia, there is a general lack of both capacity and capability to use many sources of information and to synthesise the information into an analytical position – while there

are instances where analysis is performed, there are equally many cases where there is no analysis undertaken. This is particularly evident in the area of citizen engagement, where it has been stated that the public administration and government find it difficult to deal with "multiple voices" and to take the information received and analyse it to develop solutions that will benefit the majority. This lack of capacity and capability may be a result of multifunctionalism, a key characteristic of small states; or of prioritisation in which consultation is considered a secondary activity rather than a crucial step in assuring regulatory quality and stakeholder buy-in. Due to limited resources, public administration staff are often required to be operational across multiple policy areas, which can limit the depth of knowledge in any one area. This can also impact officials' ability to prepare analysis in a form and fashion necessary to fully inform government decision making.

Analytical capacity is particularly important for ministry staff who are responsible for developing policies and legislation, and preparing briefings that contribute to political decision making. Yet analytical quality varies by ministry, and limited analytical capacity may be due to a lack of operational experience among public sector staff. This can be evidenced by HR statistics, where ministries have the largest number of officials with higher education qualifications (83.4%); the youngest staff (66.4% aged 21-40 years; and the shortest length of service (61% with length of service of 10 years of less). In addition, there is high staff turnover in ministries (where 20.4% of officials left in 2009). Low mobility of staff within and between public sector organisations also means that staff are not developing analytical and strategic thinking skills that go beyond the boundaries of their remit.

The absence of continuity of knowledge due to staff departures and an under-developed habit of documenting work can result in a severe lack of institutional memory. One consequence of low institutional memory is difficulty for the public administration to provide sound analytical advice. The issue of knowledge management in the Estonian central public administration will become more apparent as more opportunities to increase staff mobility are introduced. As such, Estonia should consider implementing strategies to ensure the collection and sharing of critical policy and programme information. Not doing so jeopardises the flow of information and will impact on the quality of decision making and implementation of programmes and policies. Such strategies should enable ease of access to information.

To counteract the lack of analytical capacity in the public administration, ministries have developed policy analysis units. However, due to a lack of time and human resources, the central ministries are operating on a skeleton staff, and thus analytical capacity still suffers. An absence of middle management impacts on vetting the quality of work that is produced. This is a problem, particularly when the public administration has a strong reputation for relying on theoretical and international best practice for policy development. Poor analytical skills and operational experience risks policies developed without sufficient linkages to the Estonian context. This "off-the-shelf" policy development impacts effectiveness of achieving policy outcomes and often results in the implementation of policies that require re-working at a later date, increasing expenditure.

During interviews with the OECD, analysis units within ministries raised concerns regarding access to sufficiently detailed raw data. It is noted that while the producers of official statistics (Statistics Estonia and the Bank of Estonia) are able to disseminate data collected for the production of official statistics, it can only be disseminated in accordance with the *Official Statistics Act* – the general principle of the Act is that data can only be

Box 5.11. **Korea's Government Knowledge Management System**

GKMC is a knowledge hub system linking the systems of 116 public and private institutions (government affairs management system, KMS of the central and regional governments, legal information and statistics, policy research reports, SERI economic reports, etc). Through GKMC, public officials can now search for any topics of interest on the integrated knowledge database, post questions on the Q&A section for replies, or join a learning community. As an unprecedented pan-governmental knowledge hub system, the GKMC resulted in the following key benefits:

First, GKMC changed the way the public sector got things done. By linking over 343 000 public administrative data, GKMC offered a wealth of shared references and know-how. The necessary information or content was just one click away for GKMC users. If they encountered a problem in conducting their work or handling a public service, users could post a question and get a reply from other users who had that information. Those interested in a particular topic could launch a community to talk, learn, and get solutions with other members. In the three years since GKMC was launched, it has become common for public officials to sign onto the GKMC site as soon as they get to the office.

Second, GKMC established a culture of connection, communication and collaboration, which had been practically non-existent in the public sector. Horizontal and vertical cyber communication became more prevalent across and among the central and local governments. The system now has 57 communities with about 11 000 users who learn and seek solutions collaboratively. Regardless of their location and affiliation, users share their knowledge on any topics of common interest, discuss and benchmark the work processes of other institutions, present best practices, and work in close co-operation.

Third, GKMC made practical contribution to raising the standards of public service delivery. The community of officials in charge of public service delivery at different institutions is a prime example. The shared best practices help members learn from each other in offering more prompt, efficient services, thereby raising the standards and quality of public service delivery. Sharing knowledge through GKMC has led to enhanced public service delivery: some indications of positive change include better serving the needs of families of multi-cultural backgrounds, the handicapped and other disadvantaged groups and making public services available on smart phones and other type of new technologies.

Source: Courtesy of the Korean Public Administration, 2010.

disseminated in a form that precludes the possibility of direct or indirect identification of a statistical unit. However, the Act does provide exceptions in order to allow dissemination of confidential data, for example dissemination of confidential data for scientific purposes (Section 38) or new services which allow the users to analyse micro-data (Sections 36 and 37). That said, due to the small size of the country, data tends to be highly personalised. In particular, there is a constant need for regional- and local-level data. This presents challenges for ministries. In addition, officials noted there is a need for more subjective and objective data, and that much citizen data is missing from IT systems started 10-15 years ago. Finally, many believe that the data is not of good quality.

Analytical units in ministries have also expressed a desire to merge data registers to improve the type and quality of data available to them; data points are currently highly fragmented. Ministry staff use their own administrative data, and data from Statistics Estonia, as well as from other sources. A preference for one data repository, with access to whole population surveys, etc. – a system similar to that available in the Netherlands – has

been expressed. While merging is possible, it is difficult as the new *Official Statistics Act* which came into effect on 1 August 2010 does not support the merging of databases. That said, it also does not prohibit or restrict the merging of different databases either. The Statistics Office can collect data from the registers (databases) and can merge these, however, collected data may only be disseminated in accordance with the *Official Statistics Act* as indicated earlier – meaning that generally ministries are not able to receive the detailed data they need. The new Act does not prohibit or restrict the merging of different databases and dissemination of data gained as a result of merging, as far as the dissemination of confidential data is in accordance with the Act. But ministries can only use the confidential data for scientific purposes if all conditions are met. Those interviewed understood the parameters by which they are able to access confidential data, but the new Act has not gone as far as they would have liked to improve access to the information they need to undertake appropriate analysis.

Critical focus needs to be given to the capacity of analysis units in fulfilling their current responsibilities as well as in positioning themselves to respond to upcoming needs to develop performance indicators and reporting to programme areas, as well as to support the development of impact assessments as part of a RIA rollout.

Notes

1. Information provided by the Ministry of Finance, Estonia.
2. Ministry of Finance, Estonia. *www.fin.ee/index.php?id=79458*.
3. General government deficit/surplus data for 2008 and 2009 sourced from Eurostat.
4. Based on the five pillars of evidence-based decision-making: political, research and technical, professional and practical, citizen, and the public administration.
5. It is noted that on 23 January 2011, the *Riigikogu* approved the policy document "Guidelines for Development of Legislative Policy Until 2018", where the use of impact assessments is listed as a priority. In addition, Government Regulation No. 10/2011 will come into effect from 1 February 2011, which gives clearer grounds for the use of impact assessments. However, the use of a regulatory impact assessment methodology is still yet to be approved by the government.
6. For the purposes of the *Survey of Engagement in Estonian Government Agencies*, stakeholder was defined as businesses, non-profit and non-government organisations.

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Chapter 6

Delivering Public Services Effectively

Estonia faces a series of inter-connected challenges to delivering high-quality public services. At the central level, the government has begun to consolidate "back-office" operations for county governments, and to experiment with rationalising "front-office" activity by merging all local State representation into one physical working environment. At the local level, however, the lack of standards and performance measures, and the mismatch between fiscal capacity and devolved responsibilities put pressure on local government service capacity. Estonia needs to take an integrated and innovative perspective in developing solutions to meet service delivery challenges. This would entail tailoring service delivery requirements to population needs, matching service sets to municipal capacity, building scale, and linking action at the municipal level with a broader vision for territorial development and regional policy. Given the many elements involved, the central/sub-national relationship will need to be strengthened through greater institutional co-ordination and collaboration.

Introduction

Citizens and businesses expect public services that are adapted to their needs and that are seamless, *i.e.,* as if provided by a single government. Effective service delivery therefore requires a single government approach that involves both central and sub-national government actors, as well as external stakeholders *(e.g.,* national and municipal associations, civil society, the private sector, and citizens). Several challenges currently inhibit Estonia's ability to take such an approach in public service delivery, including a mismatch between municipal fiscal capacity and allocation of competences; fragmentation and low levels of co-ordination and co-operation, both vertically among levels of government and horizontally at the State and sub-national levels; and a regional development policy that has low whole-of-government commitment and that may not sufficiently take into account local contexts.

Following an overview of the choices and structures that frame public service delivery in Estonia, this chapter will examine four broad sets of challenges:

1. **Reinforcing the sub-national administrative and financing structure to ensure sustainable public services:** the matter of scale and appropriate municipal size is an important factor in the sustainability and capacity of local authorities, but the debate on sub-national administrative reform in Estonia has been narrowly focused around the appropriate number of municipalities, and stalled. The inability to resolve this question has resulted in a fragmentation in service delivery and difficulty in delivering public services of equal quality, effectively and efficiently across the territory.
2. **Supporting innovation in service delivery for efficient, effective and accessible public services:** the quality and accessibility of services depends on the public administration's ability to innovate in the development and delivery of services. This will require working with both internal and external stakeholders in order to better understand user needs, to collaborate more effectively, and to involve new partners in service delivery for a more citizen-centred approach.
3. **Improving relationships across levels of government to enhance service delivery and policy outcomes:** the relationship between central and sub-national government is characterised by low levels of leadership and weak co-ordinating bodies, sub-optimal use of co-ordination mechanisms and fragmented policy implementation mechanisms, and a lack of capacity among all actors to realise public policy outcomes in a sub-national context.
4. **Taking territorial needs into account for service delivery and regional development:** public service delivery is presently based on a "one size fits all" approach regardless of local capacity and needs; by the same token, current regional planning policy appears to focus more on meeting EU requirements than on representing an "Estonian-owned" development vision for responding to demographic challenges, competitiveness and sustainability goals, and current regional development approaches.

Overview: Choices and priorities

Distribution of central and sub-national competencies

Estonia's local governments play a leading role in public service provision. Their tasks include general public services, defence, public order and safety, economic affairs, protection of the environment, housing and community amenities, health, education, social protection, and recreation, culture and religion, with education being the most important in terms of expenditure (see Table 6.1).

Table 6.1. **Municipal tasks, 2003-09**

Share of total expenditure, %

Task	2003	2004	2005	2006	2007	2008	2009
Education	43.930	45.490	43.470	41.660	42.410	42.390	45.660
Recreation, culture and religion	13.020	13.240	14.250	14.240	14.210	14.250	12.780
Economy	12.780	12.720	14.300	15.550	15.920	15.360	13.470
Administration expenses	9.280	9.260	8.780	8.690	9.140	9.160	9.390
Social protection	8.900	7.920	8.440	7.810	7.260	7.390	8.580
Housing and public facilities	7.280	6.050	5.380	5.690	5.660	6.370	5.190
Environmental protection	3.310	3.680	4.550	5.140	4.250	3.970	3.740
Maintenance of public order	0.870	0.930	0.330	0.450	0.350	0.390	0.400
Public health	0.580	0.700	0.500	0.770	0.810	0.720	0.790
State defence	0.052	0.005	0.002	0.001	0.002	0.001	0.001
Total	**100.000**	**100.000**	**100.000**	**100.000**	**100.000**	**100.000**	**100.000**

Economy includes: agriculture, forestry, fishing and hunting, energy supply, transport, communications.
Social protection includes: for disabled persons, for elderly persons, for unemployed persons, subsistence benefit.
Maintenance of public order includes: police, rescue services.

Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*, data from Ministry of Finance, Estonia.

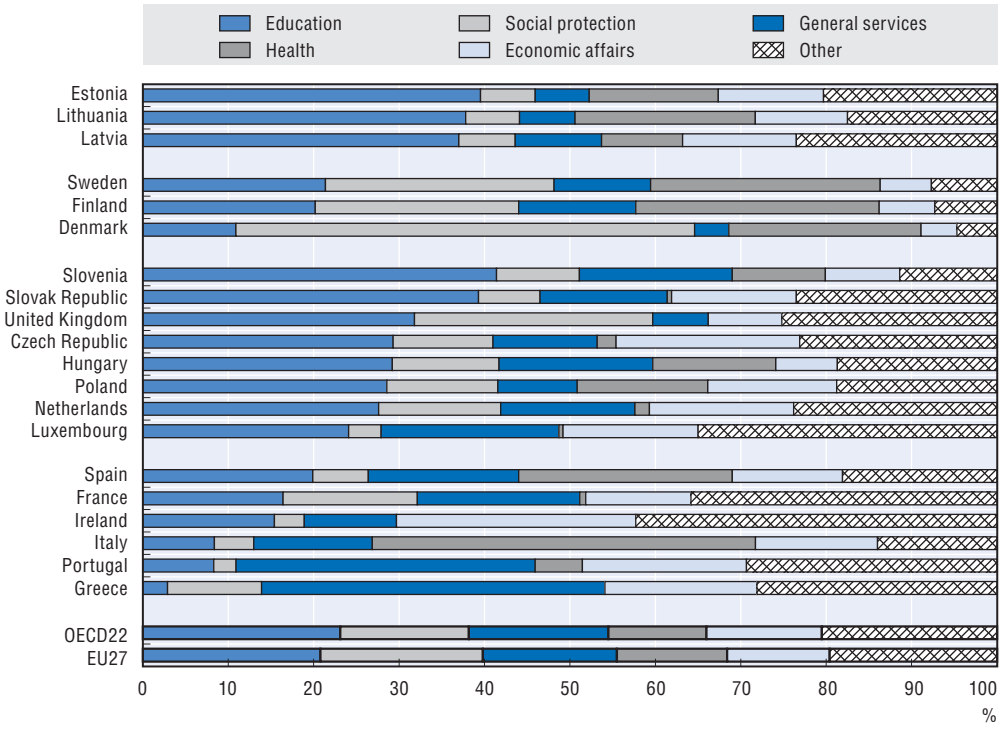
The competences and service delivery responsibilities of Estonia's municipalities are similar to those of other EU countries, including the Nordic members, but the sub-national expenditure priorities and the trade-offs made in Estonia are more similar to its other Baltic neighbours (see Figure 6.1). The three Baltic States seem to have much in common with respect to expenditure shares of municipal tasks. A high local-government share of education service expenditures and a low share of social services and healthcare is typical, especially in the three Baltic States. This is in contrast with the Nordic countries, where the social and health services represent a considerable share of local government expenditures, and in the transition countries where the share of social services is also somewhat higher.

In addition, the importance in Estonia of the central level in public expenditure is similar to that of other Baltic and transition countries. Of all the European unitary countries, local government spending is above 20% of GDP only in the Nordic countries (see Figure 6.2). In Estonia, where the total public sector share of GDP is lower than the EU (or OECD) average – at 39.8% and 46.9%, respectively, in 2008 – local government expenditure per GDP is 11.5%.

Prioritisation of public expenditures

Estonia's low share of public expenditure as a percentage of GDP reflects its strategy of limiting public spending and public sector growth. This policy has effectively limited public employment much of which occurred between 1989 and 2007, as the country transitioned from a centralised Soviet economic model to the current free market model. During this period the public sector share of the total number of employed dropped from over 75% to

Figure 6.1. **Main areas of sub-national public sector expenditure**[1]



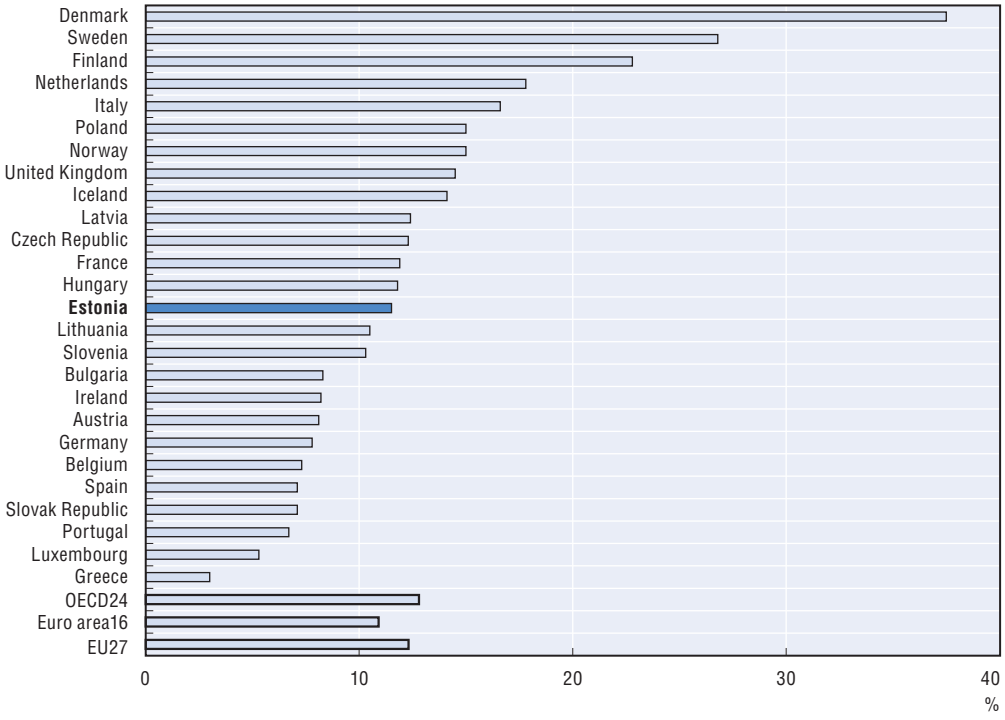
1. Classification of the Functions of Government (COFOG). **Education:** pre-primary, primary, secondary and tertiary education, post-secondary non-tertiary education, education non-definable by level, subsidiary services to education, R&D. **Social Protection:** Sickness and disability, old age, survivors, family and children, unemployment, housing, R&D, social exclusion, nec. **General Services:** Executive and legislative organs, financial and fiscal affairs, external affairs foreign economic aid, basic research, R&D related to general public services, public debt services, transfers of a general character between different levels of government. **Health:** Medical products, appliances and equipment, outpatient, hospital and public health service, R&D related to health. **Economic Affairs:** General economic, labour and commercial affairs, agriculture, forestry, fishing and hunting, fuel and energy, mining, manufacturing and construction, transport, communication, other industries, related R&D. **Other:** Housing and community amenities, public order and safety, recreation and culture, environment and defence.

Source: CEMR/Dexia (2009), *EU Sub-National Governments, 2008 Key figures*.

approximately 25% (Moisio, 2010b). Estonia's public sector focus, similar to most new EU members, has been on education in order to support long-term growth prospects. Estonia's annual expenditure on public and private primary-level educational institutions per student was just under 20% as a percentage of GDP per capita, on par with the 15 countries forming the Euro area (Eurostat, 2007 figures). Meanwhile, Estonia's total expenditure on social protection (current prices as percentage of GDP) was approximately 15%, putting it below all other EU/OECD member countries (the next lowest is Slovak Republic at about 16%), and among the lowest three in the EU overall (Eurostat, 2008 figures); and care for the elderly as a percentage of GDP was approximately 0.08% (among the lowest, together with Belgium, Greece, and Luxembourg) (Eurostat, 2008 figures). Thus in Estonia, the expenditure trade-off is with social services (and also health), where expenditures are significantly lower than among other EU countries. Given changing demographics, particularly an aging population and low birth rate, the sustainability of this approach remains to be seen.

Figure 6.2. **General public expenditure at the local government level, 2009**

As a percentage of GDP



Source: Eurostat Databases (2010).

The economic situation of Estonia's municipalities and the current sub-national financing system

Estonia's sub-national finance system is fundamentally sound, though it could be strengthened in several areas. Despite this soundness, the level of financing provided through the current system does not match the level of competences or requirements associated with municipal tasks, calling into question municipal financial sustainability. Given the tight fiscal environment for the next several years, it is critical to align the competences allocated to municipalities and the resources necessary to meet these by improving efficiency at the sub-national level.

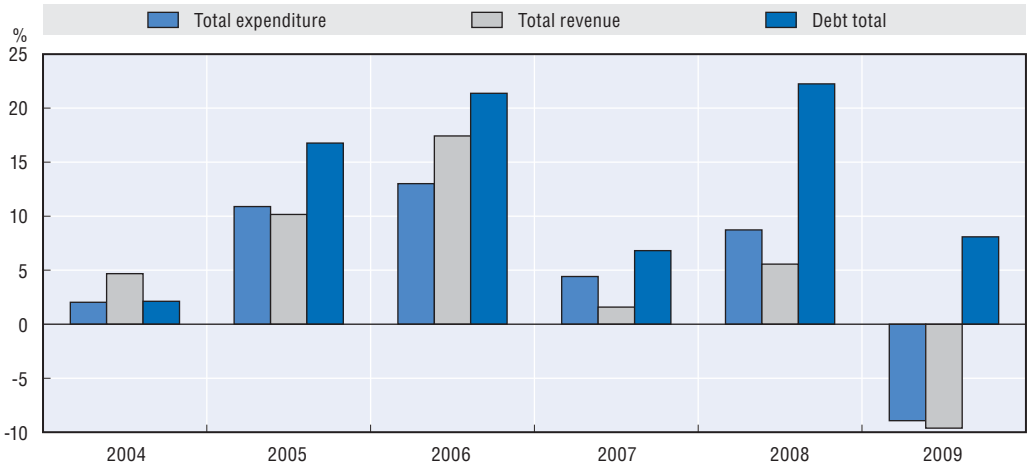
Between 2004 and 2008, municipal tax revenues grew, on average, over 18% per year, and central government grants grew at approximately 10% per year. This was paralleled by rapid growth in municipal spending. In 2005, 2007 and 2008, municipal expenditures grew faster than revenues (see Figure 6.3). While the Estonian general government debt (as a percentage of GDP) is the lowest in the EU at 7.2%, and Estonian local government sector debt (as a percentage of GDP) is still well below the EU average, the growth in sub-national debt has been among the fastest (see Figures 6.4 and 6.5).

As a result of the economic situation in 2009, municipal tax revenues dropped by 13%. This drop was accompanied by an 11% reduction in central government grants. As a result, almost all municipal expenditures were reduced that year. The impact on services, however, varies, with some (such as education) experiencing a less severe drop. Social service costs increased in part due to the rapid rise in subsistence benefit costs (see Figure 6.6).

The concern over municipal sustainability in Estonia can also be illustrated, at least in part, through per capita municipal expenditures, which vary considerably among Estonian local authorities (see Figure 6.7). For example, in 2009 the total per capita operating expenditure

Figure 6.3. **Change in Estonian municipal revenue, expenditures and debt, 2004-09**

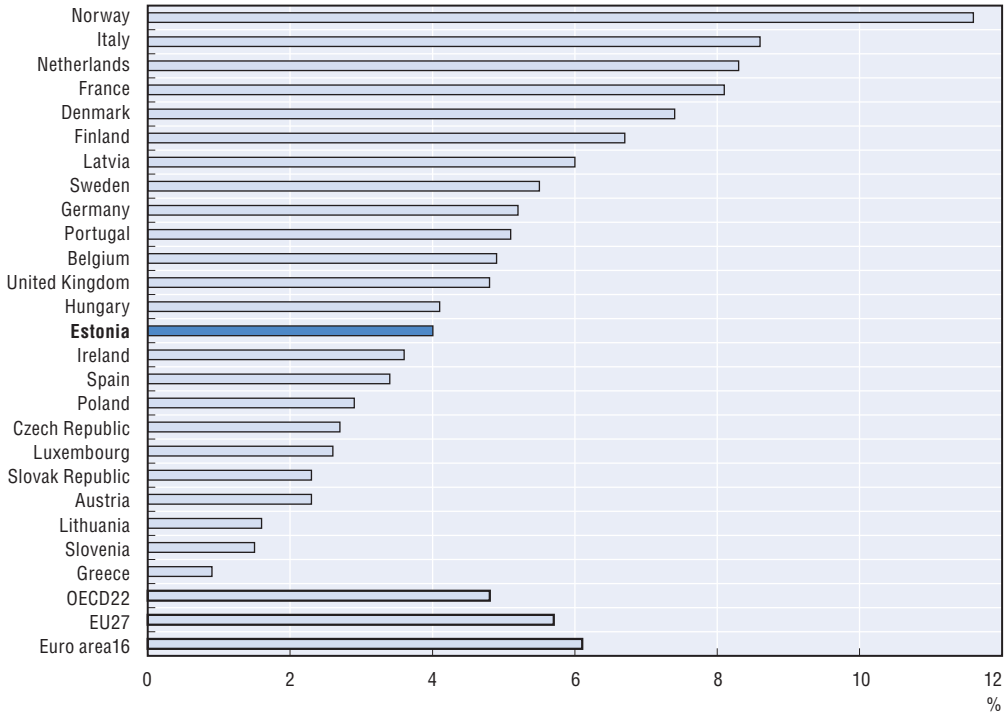
Annual percentage change



Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*.

Figure 6.4. **Local government debt in Estonia, 2010Q1**

As a percentage of GDP

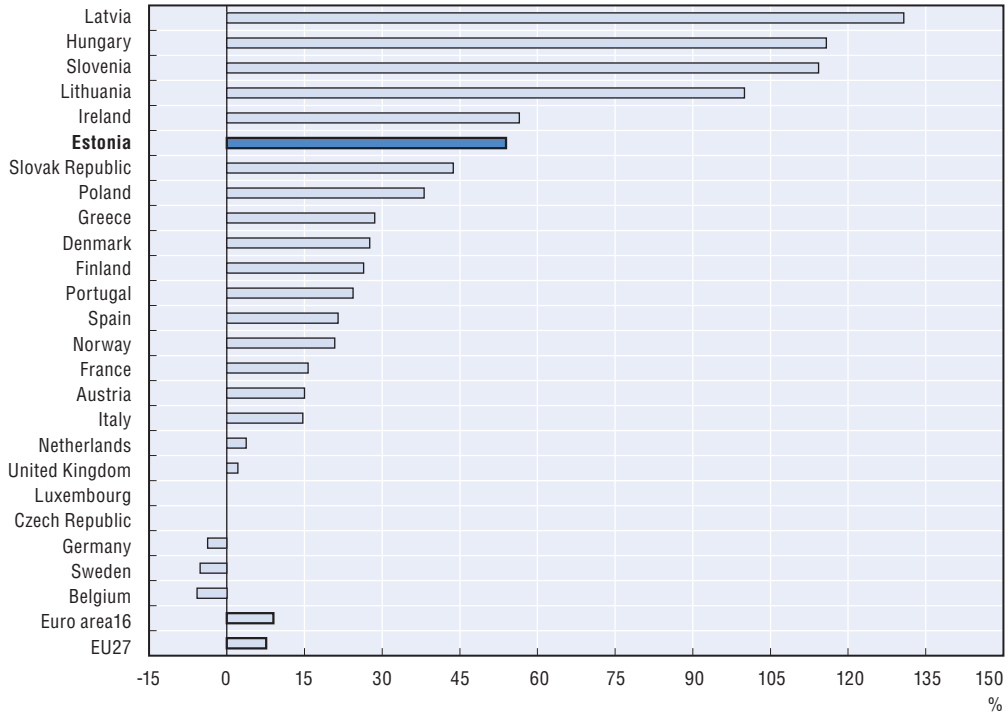


Source: *Eurostat Databases* (2010).

varied between EEK 8 000 and 42 000 (approximately EUR 510 and EUR 2 690, respectively), although most municipalities spend between EEK 15 000 and 20 000 (approximately EUR 960 and EUR 1 280, respectively). These discrepancies could be due to variations in population size or wealth, particularly in the case of "oil-shale" municipalities that receive mining fees, or another unknown factor. However, such large differences raise equity concerns,

Figure 6.5. **Local government debt, 2005Q4-2010Q1**

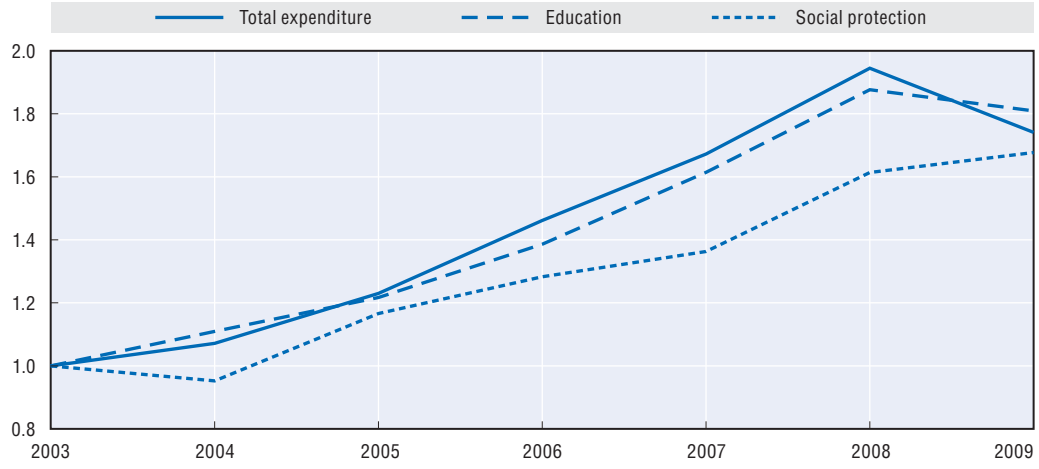
Percentage change of the share of GDP



Source: *Eurostat Databases* (2010).

Figure 6.6. **Expenditures development in main service categories**

Index: 2003 = 1



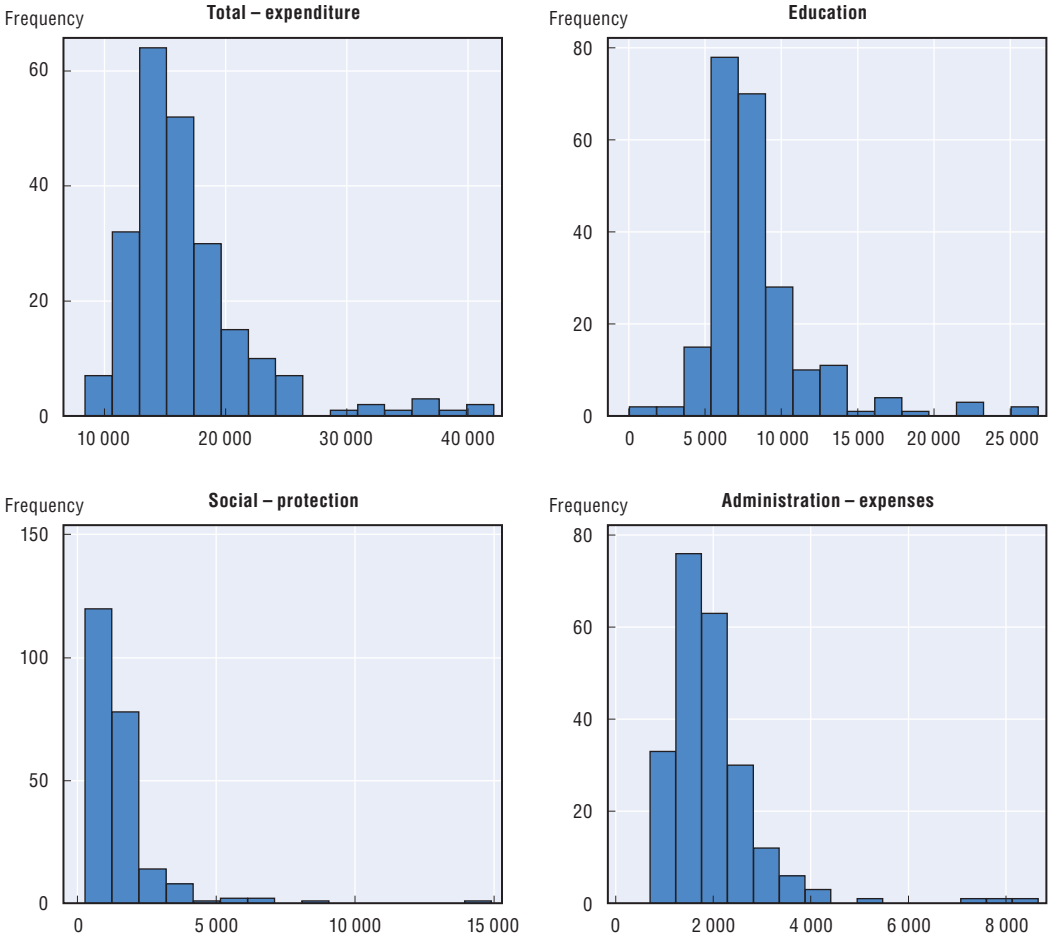
Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*.

particularly with respect to the level and quality of public services, calling into question municipal fiscal, administrative and service delivery capacity.

Lack of local flexibility in raising own-source revenue

Estonia has decentralised spending decisions, but not revenue choices. On the one hand, municipalities can choose how they spend based on municipal and citizen needs. On

Figure 6.7. **Frequency distribution of expenditures EEK/capita over municipalities, 2009**



Note: Frequency distribution presents the number of municipalities in per capita expenditure groups (the groups are automatically defined by the statistical programme employed). In the above figures, frequency distribution shows the dispersion or concentration of municipalities based on per capita expenditure in particular service or cost areas.

Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*.

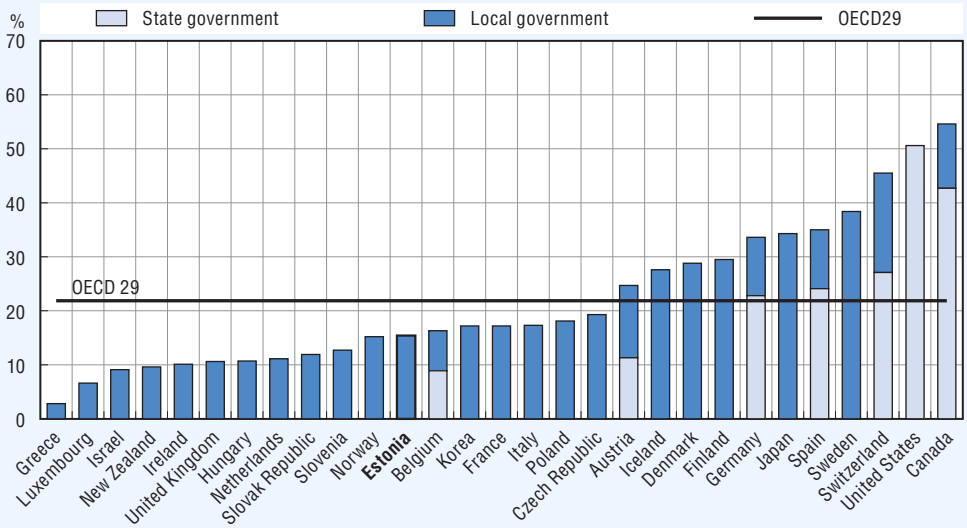
the other, the government retains a strong degree of control, seen in the relatively low percentage of sub-national share in general government revenues and expenditures (see Box 6.1). In practice, municipal finances are almost entirely controlled by central government as the centrally regulated revenues (personal income tax, grants) form over 80% of total municipal revenues (see Table 6.2). Despite this, it has been difficult for the central government to curb municipal spending growth in times of rapid economic expansion.

Municipal funding is mostly based on own source revenues (taxes, user fees and sales revenues) (see Table 6.2), which aligns with the mainstream view of public finance. Furthermore, the fiscal equalisation mechanism has elements that diminish both the vertical (*i.e.,* personal income tax as a shared tax) and horizontal fiscal gaps (*i.e.,* the equalisation grant and block grants). The grants are generally non-earmarked, which again, is in line with the mainstream view of public economics. Municipal taxes are mostly based on personal income tax and to a minor degree on land tax. Land tax or property taxes alone would not be sufficiently "profitable" to fund the wide range of tasks attributed to Estonian municipalities. In addition, it is generally advised that land taxes be used to finance infrastructure and not

Box 6.1. **Degree of decentralisation in Estonia**

Figures 6.3 and 6.4 put the degree of Estonia's financial decentralisation in perspective *vis-à-vis* OECD countries. In terms of both municipal revenue as a percentage of general government revenue and municipal expenditure as a percentage of general government expenditure, Estonia is below the OECD average. This reflects limited fiscal decentralisation, which in a small country is not unusual.

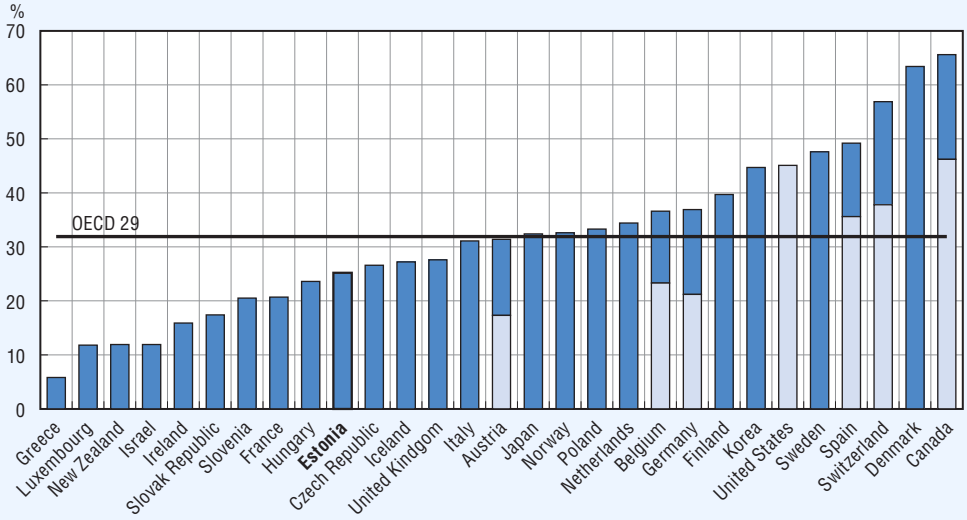
Sub-national revenue as a percentage of general government revenue, 2009



Notes: Data for Australia, Chile, Mexico, and Portugal are missing. Transfers between levels of government are excluded. Korea, New Zealand, Switzerland, United States and Israel: 2008. Japan: 2007. Local government is included in State government for the United States. Social Security funds are included in Central government in New Zealand, Norway, the United Kingdom, and the United States.

Source: OECD (2010), *National Accounts Statistics*, OECD, Paris.

Sub-national expenditure as a percentage of general government expenditure, 2009



Notes: Data for Australia, Chile, Mexico, and Portugal are missing. Transfers between levels of government are excluded. Korea, New Zealand, Switzerland, United States and Israel: 2008. Japan: 2007. Local government is included in State government for the United States. Social Security funds are included in Central government in New Zealand, Norway, the United Kingdom, and the United States.

Source: OECD (2010), *National Accounts Statistics*, OECD, Paris.

Table 6.2. **Municipal revenue sources, 2003-09**

In %

	2003	2004	2005	2006	2007	2008	2009
Taxes	46.48	47.57	47.66	46.85	52.49	54.62	53.55
Grants	39.77	35.56	35.16	33.23	33.21	32.32	32.31
Sales of goods and services	8.39	10.94	10.43	9.03	8.87	9.66	10.77
Sale of tangible and intangible property	3.22	4.04	4.80	8.56	2.86	0.94	0.89
Revenue from property	1.44	1.53	1.23	1.65	2.03	2.02	1.98
Other income	0.71	0.37	0.71	0.68	0.54	0.44	0.50
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Municipalities have the right to regulate the rate of land tax between 0.1 to 2.5 times the taxable land price. However, land value has not been updated since 2001.

Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*.

re-distributive services. The corporate income tax in Estonia is strictly a central tax. This is positive, as the corporate tax base is even more mobile than the personal income tax base.

The 2009 drop in tax revenue is significant, given that tax revenues account for slightly more than one-half of all municipal revenues, and personal income tax is the most important source of income for municipalities (see Table 6.2). The high proportion of revenue represented by personal income tax is in contrast with other OECD countries, where the share of personal income tax is smaller and several sources feed local government tax revenues (see Table 6.3). As a central government tax, the municipalities have little to no power over the tax in terms of rate and base. Each year the central level, usually in negotiation with the national municipal associations, determines the tax rate and the municipal share. Estonia had a flat-rate income tax of 21% in 2010.[1] The rate earmarked to municipalities was 11.4% of the state's total personal income tax revenue *before* deductions and exemptions. Thus, in practice, the municipal share of this tax in 2010 was over 80% of the personal income tax revenue because deductions and exemptions are only considered in the central government's share. The central government share was therefore less than 9.6%. Per capita income tax revenue varies substantially among municipalities, and municipal size does not seem to explain the variation

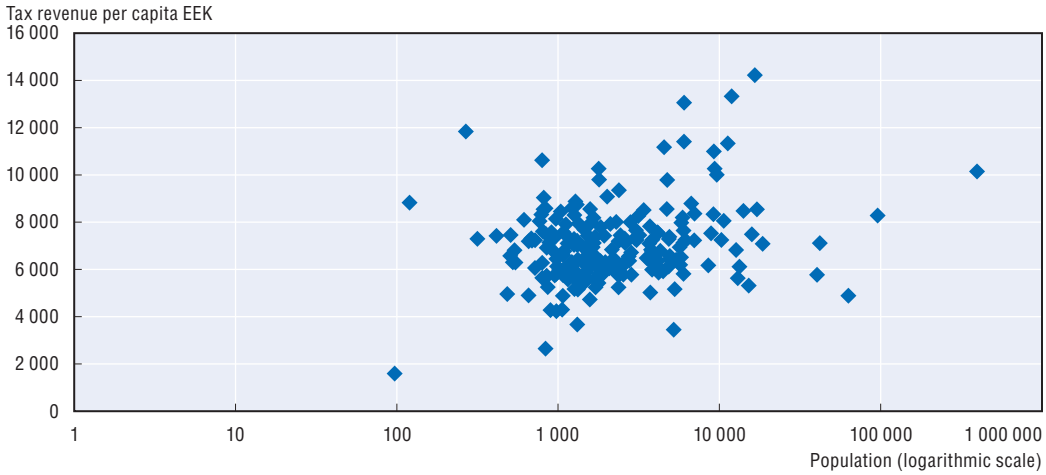
Table 6.3. **Type of sub-national tax level**

Type of tax	As % of total sub-national government taxes	
	OECD[1]	Estonia 2009[2]
Taxes on income, profits and capital gains	41.7	91.7 (PIT)
Of individuals	35.5	91.7
Corporate	5.9	–
Unallocable	0.3	–
Social security contributions	0.3	0
Taxes on payroll and workforce	3.3	0
Taxes on property	27.3	7
Taxes on goods and services	21.4	0.6
Other taxes	5.9	0.8

1. Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Iceland, Italy, Japan, Korea, Mexico, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and Turkey.
2. Estonian Ministry of Finance.

Source: Blöchliger, H. and O. Petzold (2009), "Taxes or Grants: What Revenue Source for Sub-Central Governments?", *OECD Economics Directorate Working Paper No. 8*, OECD, Paris; Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*; data obtained from Estonia Ministry of Finance.

Figure 6.8. **Municipal per capita tax revenues and population size, 2009**



Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*.

(see Figure 6.8). This indicates that small municipalities are not necessarily the poorest, which can impact decisions concerning sub-national structural reform.

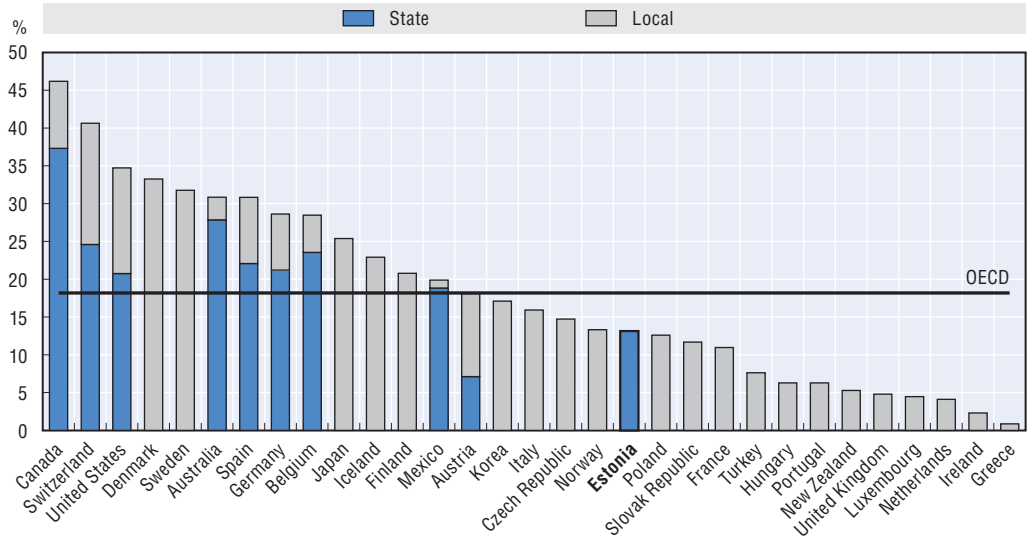
Land tax is the next most important tax revenue for municipalities. Municipalities are free to set land tax rates within the limits established by the central government (presently, the band is between 0.1% and 2.5%). They are also free to set different rates in different zones in their area and to give tax relief for special taxpayer groups. In 2010, land tax rates varied between 0.7% and 2.5%, with an average tax rate of 1.82%.[2] While the permissible band rate for land tax is still at the level of 2001, land tax revenues have increased slightly due to an increase in land tax rates within this band by individual municipalities.[3] Land tax rates were increased in both small and large municipalities, and thus there is no correlation between population size and land tax rate. A majority of municipalities increased their land tax rates in 2007 and 2008. Other tax revenues form a very small share of municipal incomes.

Compared to other OECD countries, however, the revenue generating power of Estonia's municipalities is low (see Figure 6.9). Municipalities have discretion only on the land tax rates and on some minor taxes that are seldom used.[4] This system is similar to what is seen in the Czech Republic and in Poland, but significantly different from the Nordic countries (except Norway), where taxing power is higher.

State financing

Fiscal equalisation in Estonia primarily consists of block grants, an equalisation grant, and a "stabilisation grant". In 2010, the total amount distributed to municipalities through these grants was approximately 90% of total grant distribution, representing EEK 4.7 billion (see Table 6.4). Block grants are comprised of the education grant, two grants for social services, and a small grant for island municipalities, as well as one for roads. The education grant is the largest of these. The equalisation grant aims to level out disparities in fiscal capacity among municipalities by taking both the service cost factors and the revenue base into account. In other words, the formula is used to give more grants to municipalities with higher costs and/or lower tax bases. It is based on a formula that measures the difference between the estimated costs and the estimated revenues of each municipality. If the difference is positive, then 90% of the difference is paid to the municipality as an equalisation grant. Thus, the formula takes both the service needs and tax base into account. The equalisation grant is financed entirely

Figure 6.9. **Municipal taxes to total taxes in Estonia compared to other OECD countries, 2005**



Source: Blöchliger, H. and O. Petzold (2009) "Taxes or Grants: What Revenue Source for Sub-Central Governments?", *OECD Economics Directorate Working Paper No. 8*, OECD, Paris; Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*.

Table 6.4. **Grants to municipalities in 2010**

Grant category	% share
Education block grant	65.8
Equalisation fund	23.2
Subsistence benefit	7.4
Support for providing social benefits and services	0.9
Support for stabilising local governments' revenue base	2.5
Additional support for rural municipality islands and municipalities with an insular region	0.1
Total	**100**

Source: Ministry of Finance (2010), unpublished data on grants to municipalities, Ministry of Finance of the Republic of Estonia, Tallinn.

by the central government. (Municipalities with estimated resources above the estimated costs do not contribute to the equalisation fees.) The stabilisation grant targets aid to municipalities that have seen a dramatic drop in their tax bases due to the global financial and economic crisis. Its goal is to keep the effect of a tax base drop from 2008 to 2010 at or below 20%.

The Estonian grant system for current expenditures is built on non-earmarked grants which are either general (*e.g.*, the equalisation grant) or block grants (*e.g.*, education and social services). The fact that, in practice, there are no earmarked grants on operating expenditures underscores the spending autonomy of Estonian municipalities, which could be considered a strength from an efficiency standpoint.

Meanwhile, investment grants are mostly based on matching grants. Many of these are actually EU grants that are applied for and received by municipalities, but that come through the central government budget. In other countries, investment grants seem to be of limited relevance. For example in Finland, investment grants are used only for education and culture services, and their role is very small.

Overall, the structure of the Estonian local government financing system seems to be without any major problems, and Estonia has been able to avoid some of the errors made by other countries when designing their municipal finances. But it could do even better by adjusting the grant system and by allowing more revenue-raising discretion at the local level. Estonia could also improve in the municipal finance dimension by building municipal size. With almost the same tasks as the municipalities in the Nordic countries, but only one-tenth (or twentieth) of their size, attention should be paid to Estonian municipal structure (see next section).

EU funds

The role of EU funds at the municipal level is quite large. A considerable share of the present EU- and EEA-funds received by Estonia is used to finance municipal investment projects. EU and EEA funding always involves a municipal self-financing portion that varies between 15% and 20%. The low variance of the self-financing share reflects the fact that all municipalities, regardless of their wealth or any other factor, are treated more or less equally. The fact that local infrastructure projects *(e.g.,* schools, child day-care centres, etc.) are funded with EU- and EEA-grants that do not take the recipients' tax raising capacity into account is problematic. This is because the poorest municipalities may not be able to fund their own share and therefore would have to refuse the grant. Tax raising capacity is not specifically taken into account when deciding the matching rates. Yet, even if it were the system would remain weak in this respect. It would be better if the matching rates were defined by a formula that is inversely proportional to a municipality's per capita personal income.

Reinforcing the sub-national financing and administrative structure to ensure sustainable public services

As governments at all levels try to do more – or better – with less, questions of municipal capacity arise that centre on resources and the ability to fulfil the obligations associated with the social contract that government maintains with its citizens. Adding to the pressure are citizens, who increasingly demand better access to a wider variety of high-quality services regardless of whether they live in urban or rural areas. One way that governments juggle these elements is through decentralisation, and the devolution and assignment of competences (tasks) and obligations.

Improving the fiscal sustainability of municipalities

In most OECD countries, central governments created fiscal packages to support municipalities in the face of the global financial and economic crisis (Blöchliger *et al.*, 2010). For example, in Finland, the central government temporarily increased the municipal grants and the municipal share of corporate tax revenues to support the municipalities. As a result, the nominal municipal revenues and expenditures in Finland grew slightly even in 2009. Unlike most of its OECD counterparts, Estonia did not have a pro-active rescue plan for the municipalities that were worst hit by the economic crisis. The primary tool used through 2010 was the stabilisation grant, which seems too small to have had an effect. The government also established an "Insolvency Fund" to which municipalities in distress could apply. During interviews it was reported that even if in dire straits municipalities tended to avoid applying to this fund, and thus the disbursements from it were low. Estonian officials expect that in 2011 applications to this fund may increase.

The global financial and economic crisis impacted all levels of government to significant and unexpected levels. Estonia's sub-national governments were disproportionately affected[5] given a drop in taxable revenues due to unemployment compounded by the reduction in the level of personal income tax earmarked to local governments (from 11.93% in 2009 to 11.4% in 2010). At the same time, however, the central government has taken more decisive action to reduce operating expenditures in 2009 than has the municipal level. This means that despite a bleaker fiscal outlook, municipalities have not been able to adjust their expenses – either individually or through improved co-operation – raising the issue not only of fiscal sustainability, but of overall capacity to create change as well.

The lack of tax discretion for municipalities is probably one of the most problematic elements of the Estonian municipal finance system, having a direct impact on municipal financial capacity and thus public service delivery. The low revenue-raising powers of local authorities means that, in practice, they have limited discretion in revenue allocation beyond the centrally mandated services they must provide. This situation is sub-optimal if greater decentralisation is to facilitate efficiency improvements based on different public service/tax mixes to satisfy the diverse expectations and service requirements of Estonian taxpayers and voters. It seems incongruous that, while Estonia believes strongly in a market economy, it is not willing to use greater fiscal decentralisation as a tool to improve and maintain efficiency in local public services.

One option is to consider a local income tax that will give voters and taxpayers more autonomy in their municipalities and enhance local democracy. In practical terms, if Estonia were to explore such an option, it could consider maintaining a flat-rate central level personal income tax that still absorbs exemptions and deductions, and complementing this with a local income tax. For the local income tax, the tax base could be centrally decided, (including exemptions that may not be considered in the central level personal income tax) while the tax rate is left to municipal discretion. In order to avoid harmful tax competition and a "race to the bottom" the tax rate, especially at the outset, could vary within a centrally regulated band – similar to what is currently practiced with respect to the land tax. Implementing such a policy, however, would require that Estonia revisit its residential registration requirements; currently, many people are "official residents" in municipalities where they do not physically reside.

Grant system design

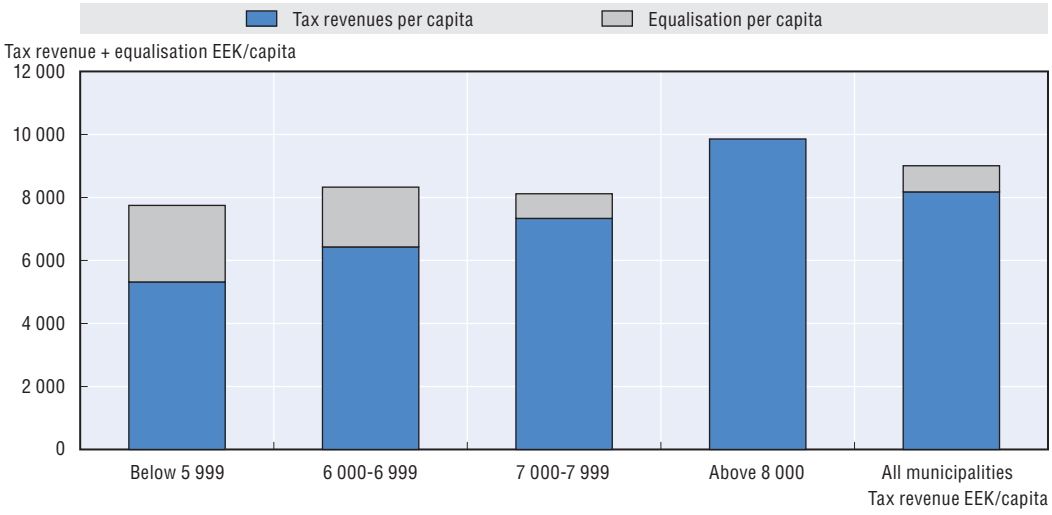
There appears to be room to improve co-ordination within the grant system's design as block grants paid to the municipalities are not taken into account in the equalisation grant,[6] although the block grants also compensate higher costs. This may result in a system that is unnecessarily complicated. For example, the education block grant measures the education need in a rather detailed way including maintenance, school lunches, text book and work materials, etc. The equalisation grant takes the population aged between seven and eighteen into account, as well as the education expenditures that are covered by the education block grant. The complexity of the system could risk duplication of need calculation, which may distort equalisation outcomes. More specifically, some population groups, *e.g.,* schoolchildren, seem to be favoured in this system. Whether this is intentional or not is unknown, but if it is, then there are easier and more transparent ways to reach this goal.

There is also room to simplify the grant system's implementation in some cases. For example, the block grant for education is defined using a complex method. By implementing the education grant at the school level the government is maintaining the possibility for

small schools to remain open, and permitting municipalities to be in charge of school network decisions. This is in keeping with a number of values surrounding education in Estonia (see Chapter 7: "Case Study One: Estonian Education – Sustaining High Quality Schools"). It does not however, build an incentive for municipalities to rationalise their school networks; in fact, it may be doing the opposite. This is because the need for teachers is defined at the school level, and in small schools classes can be smaller than the minimum level (which is supported with extra grant funds from the central level). The municipality has an incentive to maintain many small schools, as it is able to obtain more grant funding than if it had larger schools. There is also a possibility for grant recipients to affect the indicators used to define the grant, which is also problematic. While it is too soon to determine the full incentive impact of the new education grant system on municipal behaviour, if municipalities do not rationalise school networks on their own, then the state may need to adjust the education grant system to reinforce the incentive. The other block grants (*i.e.*, all others excluding the education grant) are based on yearly determined fixed budget amounts. The formulas for these grants, which are simple and reasonably transparent, are used to distribute the amount among municipalities. Estonia might choose to strengthen these further by re-evaluating the number and type of indicators associated with the formulas, in order to better take social service needs into account.

The data for tax revenue and equalisation grants in 2009 suggests that the equalisation grant succeeded in diminishing the differences in tax bases, especially at the lower end (see Figure 6.10). However, even after the equalisation grant, the revenue in the top group is about 20% higher than in the other municipalities. While it is certain that many of Estonia's municipalities are undergoing a rapid transformation, particularly the wealthier communities around Tallinn City, thereby adding to the burden of meeting service and infrastructure demands due to population increases, needs-factors could take this into account in the grant system. Thus, in the future Estonia may wish to consider changing the equalisation so that the wealthiest municipalities contribute to its funding. Such models are used in Finland and the other Nordic countries.

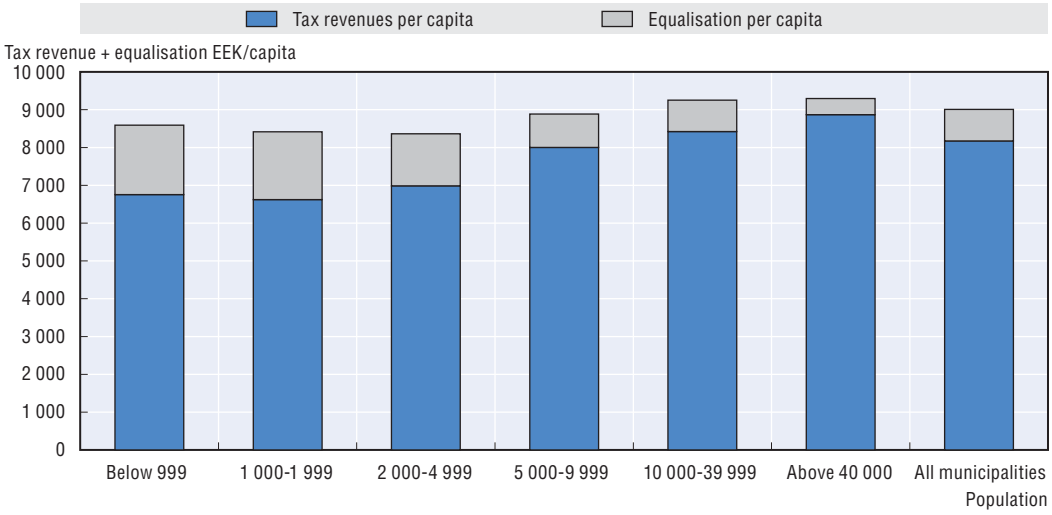
Figure 6.10. **The effect of the equalisation grant at different levels of municipal tax revenue, 2009**



Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*.

The equalisation effect can also be examined through population size. Figure 6.11 illustrates that the equalisation grant is most effective among the smallest municipalities. It is interesting to note that, on average, there is not much difference in the tax revenues and equalisation between municipalities with populations of 5 000 or less. This can have an implication for municipal mergers: if the aim of the mergers is to create economically stronger municipalities, then it would be best to merge the small municipalities with bigger municipalities rather than with other small municipalities.

Figure 6.11. **Municipal per capita revenues by population group, 2009**



Revenues are comprised of grants and own revenues.

Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*.

Some consideration should be given to improving the grant system for example by separating cost equalisation and revenue equalisation. There are two ways to address this. The first choice could be to separate cost equalisation and revenue equalisation so that the block grant system would take care of the cost equalisation part, and equalisation would ensure that all municipalities have a certain minimum revenue base. The revenue or cost equalisation could be financed partly by municipalities themselves. For example, the Finnish cost equalisation is totally financed by central government, but the revenue equalisation is totally funded by the municipalities themselves. In Sweden, the system is similar to the Finnish, except that there the cost equalisation is financed by municipalities and revenue equalisation is mostly financed by central government. Norway and Denmark have their own application of cost and revenue equalisation. These models could be tailored to fit the Estonian case. The idea of municipal participation in the costs of equalisation (either cost or revenue equalisation) is important because it forces the municipalities to commit into the equalisation and to monitor the functionality of the system.

The second option would be to reform the present equalisation system so that the education and social services block grants are merged into the equalisation grant. This could be considered if after a reasonable period of time it appears that adjustments are necessary to the formula for the education block grant introduced in 2008. In this option, the costs for the main municipal services would be defined in the equalisation model and then compared to the revenue base, as in the present equalisation. The municipalities with calculatory costs higher than calculatory revenues would be recipients of the grant. The municipalities that

have higher calculatory revenues than costs would not receive the grant.[7] In this option, there could still be separate block grants, but their size should be limited.

The democratic dimension

The low level of municipal fiscal independence may negatively affect the political activity of the population, and thereby threaten local democracy. The turnout in local Estonian elections, while improving dramatically from 40% in 2005 to 60% in 2009, remains somewhat lower than in the Nordic countries, though it is catching up to Finland and Norway (see Table 6.5). This may reflect the present powers available to municipalities. Recent research evidence from the Nordic countries suggests that political participation correlates with local discretion and with public service efficiency (Borge, 2010; Blom-Hansen, 2010; Dahlberg, 2010).

Table 6.5. **Comparison of voter turnout in local elections**

	Voter turnout (%)	Year
Estonia	60.0	2009
Denmark	69.4	2005
Finland	61.2	2008
Norway	61.2	2007
Sweden	78.3	2006

Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*.

Improving municipal scale

As governments strive to "do more – or better – with less" they are increasingly focused on building critical mass as a means to achieve better public policy results at the sub-national level. The issue of an optimal size for municipalities – one that allows for balance between democratic representation/participation and for management efficiency – has been a long-standing and endless economic debate. Detecting the presence of economies of scale at the municipal level, and identifying an "optimal size", is difficult at best (OECD, 2006c). It also is context dependent. In Japan, some analysis shows that the optimal size would be 120 000 inhabitants (based on 1990 figures) in order to obtain the lowest unit costs of public services, putting 80% of Japan's municipalities in the "under-populated" category (OECD, 2005a). Figures for Canada range between 10 000 and 50 000, and are 5 000 in Spain (OECD, 2006b). In a similar pursuit, Luxembourg's Ministry of Interior and Spatial Planning (formerly the Ministry of Interior and Territorial Planning) undertook extensive analysis, developing a breakdown of staff and services offered in its 116 communes. It found that communes which could be considered as viable units for the delivery of basic public services were those with a population of at least 3 000 inhabitants (OECD, 2007c). These are all examples of minimum service areas that are defined in terms of the number of people required in a municipality to make the provision of public services viable.

The same issue can also be considered strictly in terms of the service being provided. In this case, the number of people may vary depending on the service, as seen in Finland. Finland has determined that for hospitals the most suitable catchment area is 20 000 people, but for vocational training it is 50 000. However, this can lead to the establishment of multiple and overlapping service areas that require municipal capacity to manage. Population numbers for municipalities or services can link directly to issues regarding the

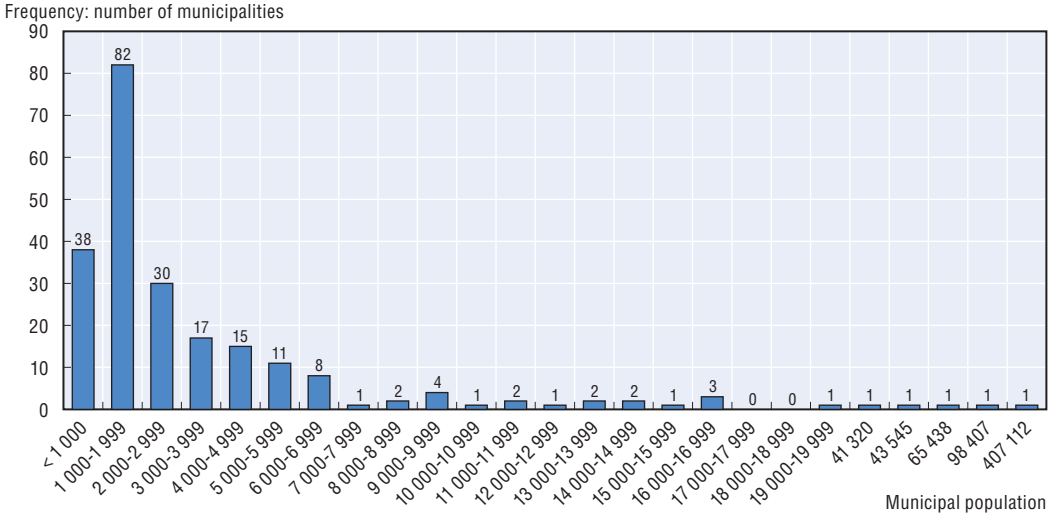
number of municipalities in a country, as the number of people a municipality may need in order to effectively meet the service needs of citizens can correlate to the number of municipalities a country may target if it is undertaking structural reform.

The challenges to fiscal, administrative and service delivery capacity at the local level in Estonia are complex and it is unlikely that they can be solved one dimensionally. In other words, simply addressing finances will not be enough. Nor will it suffice to force agglomerations, particularly without building capacity, creating a business case,[8] and linking this to regional development objectives. In addition, it could leave certain demographic groups in the periphery of socio-economic development. An integrated approach where the service sets required of municipalities match their capacity and where matters of scale are comprehensively addressed could provide the strongest and most sustainable solution. This does not preclude mergers, nor does it call for asymmetric structures or a second tier of government. It does call for clear alignment of responsibilities with capacity, and a democratic element supporting initiatives to build scale.

Small municipalities fragment capacity

A point to highlight about Estonian local government is the small size of municipalities in terms of population (see Figure 6.12). In 2009, there were only 44 municipalities (19% of total) with a population greater than 5 000 inhabitants. Bearing in mind that municipalities are expected to provide most social and education services, the small municipal population size is perhaps the most significant problem in the Estonian local public sector. Though empirical research on the effects of municipal population size on efficiency and effectiveness is scant, the policy trend in many European countries has been towards creating larger local authorities. The Danish municipal reform in 2007 is one example (the average municipal population in Denmark is now above 56 000). Also, in Finland the aim of the government is to create stronger municipalities by a combined approach of horizontal co-operation and voluntary mergers. In Estonia, the municipal size impacts municipal administrative capacity, and service production and delivery. It also puts pressure on the fiscal equalisation system.

Figure 6.12. **Number of Estonian municipalities by population group, 2009**



Source: Moisio (2010), "Estonian Sub-National Finance", unpublished *Working Paper*, data from Statistics Estonia.

The present Estonian municipal size is also challenging because of future demographic change. The total population in Estonia has already diminished by almost 7% over the last 15 years due to low birth rates and negative international net migration. The Estonian population is ageing, and the share of children and young adults has dropped dramatically during the last decade. Although the Estonian government is now taking steps to ameliorate the situation – by improving parental benefits, the child daycare system, child protection, and preventive healthcare measures – trends take time to shift.

The demographic change will inevitably put severe pressure on the Estonian social service sector in the short and medium term. The education sector will need to adjust as well, given the drop in the number of children. Between 2000 and 2010, there were only 41 municipalities where the population grew, and in only 10 municipalities the population grew every year during that period.[9] In 2000, the share of children of the total municipal population was above 20% in most municipalities, but in 2010 this was the case only in areas around the largest urban centres. Northern Estonia is the only region where the share of the elderly population is still quite low. The demographic change in the coming decade(s) will likely most affect the poorest rural municipalities in the southern part of Estonia.

Matching service sets to municipal capacity

As a means to build greater sensitivity to municipal typology, citizen service requirements, and service delivery obligations, Estonia may wish to consider a classification system for its municipalities that could address concerns of capacity as well as scale. Adjustments of this sort may be well timed in light of the Supreme Court Decision of Spring 2010 (see Box 6.2) requiring the central government to provide greater clarification regarding the repartition of competences between the central and local levels, as well as the financing mechanisms supporting these.

Box 6.2. **The Estonian Supreme Court's ruling regarding the clarification of central *versus* sub-national competences**

In Spring 2010, Estonia's Supreme Court ruled in a case brought before it by the City of Tallinn against the central government concerning the constitutionality of the government's reduction of the rate of personal income tax re-distributed to municipalities. While the Court ruled in favour of the government, it did indicate that there was a need to clarify the allocation of competences between the central and sub-national levels. In addition, the costs associated with these tasks would have to be clearly established, as well as their funding sources.

Whether or not greater clarity is achieved remains to be seen as: *a)* the government has been focusing first on the central-level responsibilities that it is choosing to devolve; and *b)* previous cost analysis of sub-national responsibilities reportedly has not focused on real costs. While the costs to perform a task are considered, the hidden costs often are not. Thus there is a question regarding the realism with which the costs will be established.

Source: OECD interviews.

Any adjustment in the allocation of competences should not relieve local authorities – regardless of their size – from the responsibility of delivering high quality mandated services. The intention is to identify ways that can make it easier for all municipalities to meet at least a basic set of quality services, which is not currently the case in Estonia.

Accomplishing this can require municipalities to re-evaluate their capacity with respect to service provision, and in many cases they may be confronted with a need to build scale in order to meet the minimum set of services they must provide. Municipal governments should be able to choose how they will accomplish this – if through horizontal co-operation, via mergers, or if they are able to do so alone (a minority of cases). Municipalities would be required to deliver services aligned to sets established by the central government which take into consideration the real cost of production and the revenue base required to meet these costs.

Many OECD countries face the problems of fragmentation and ineffectiveness in public service delivery often associated with, but not exclusively resulting from, many and small municipalities. Luxembourg, like Estonia, is a small, unitary state, with a single tier of sub-national government. In Luxembourg, as in Estonia, a lack of resources render municipalities unable to meet compulsory service tasks in a manner that is efficient and appropriate to quality standards (OECD, 2007c). To address this, Luxembourg proposed defining three categories of municipalities (communes): a Basic Level comprised of rural communes with between 3 000 and 3 500 inhabitants, and which would provide basic public services only (75% of Luxembourg's 116 communes fall under this category); an Intermediate Level of communes (28 communes) with more than 3 500 inhabitants, and which are responsible for basic public services as well as intermediate public services; a Higher Level, which is comprised of the City of Luxembourg and Esch/Alzette "Nordstad" (Ettelbrück and Diekrich), and which are responsible for basic public services, intermediate public services, and advanced public services (see Table 6.6) (OECD, 2007c).

Table 6.6. **Commune typology under the proposed Integrated Concept of Territorial and Administrative Reform in the Grand-Duchy of Luxembourg**

Classification level	Name	Public services provided	Number of communes within the classification level
Higher level	Advanced-level CDA Mid-level CDA	Excellent quality, high standard public services 1. Basic public services 2. Intermediate public services 3. Advanced public services: • Judicial services • Full health services (hospitals, retirement homes, etc.) • General, vocational, continuing and advanced training establishments (high schools or vocational training schools) • Regional emergency response centres • Cultural, sports and leisure facilities	3 (1 advanced and 2 mid-level)
Intermediate level	Regional CDA Suburban communes	1. Basic public services 2. Intermediate public services: • Health centre • Schools for post-primary education	28
Basic level	Rural communes with a population of 3 000 to 3 500	1. Basic public services: • Territorial and citizen services • Pre-school and primary education • Early learning • Out-of-school facilities	86 (approx. 75%)

Source: Adapted from OECD (2007), *OECD Territorial Reviews: Luxembourg 2007*, OECD, Paris.

Luxembourg's proposal, therefore, looked at the matter from a perspective of municipal capacity, aligning service bundles to fiscal ability, rather than building ability to meet service bundles. Thus, in the first instance while indeed some municipalities would have to grow in size, there is room for them to remain small. In the second instance, the tendency would be to create municipalities with large population bases. This could, however, result in large poor municipalities unless the matter of fiscal capacity were directly addressed. Should Estonia choose to follow an approach similar to that proposed in Luxembourg, it would require a feasibility study and adaptation to the Estonian context. Thus, the government would need to identify its own number of municipal levels, the services to be provided in each, and the population figures required to cover the costs of service production and delivery. Nonetheless, this example represents one way of aligning service delivery to the size and capacity of a municipality. It could also address service-quality concerns, as quality criteria could be factored into cost assessments making it easier to ensure that even the municipalities in the Basic Level can deliver their responsibilities to a standard level of quality. This could begin to harmonise the quality of public services across the territory. At the same time it guarantees access to a set of basic public services regardless of municipal size.

Building scale

Horizontal co-operation is the primary mechanism to build scale and, thus capacity. Such co-operation can range across a spectrum from "non-integrated" or "quasi-integrated," *i.e.,* voluntary co-operation among independent municipalities, to "integrated," *i.e.,* mergers, both voluntary and not. Estonia has pursed both paths, seeking to induce greater co-operation in service delivery among its municipalities, as well as promoting voluntary mergers. In each instance, however, the support from the central government has been weak, and incentives for the municipalities to co-operate are low. This said, Estonia's municipalities do co-operate, and it has been observed (as well as experienced by local officials) that municipalities that either work together or merge are in a better position than those that do not. Since the introduction of the Law on the Promotion of Voluntary Mergers in 2004, the number of municipalities has decreased by 19, from 245 to 226. Because there were no parameters set – either in terms of desired total number of municipalities, minimum municipal size, or time-limit to act – it is hard to determine a level of success. Unless objectives are clearly established and incentive mechanisms are built into the system, along with associated guidelines and legal requirements, voluntary non-integrated co-operation may not evolve much further, and voluntary mergers may remain few and far between.

"Non-integrated" horizontal co-operation as a means to build scale

The idea that Estonia's municipalities do not co-operate or do not co-operate sufficiently may be misplaced, and the lack of statistical data on municipal co-operation in Estonia makes it difficult to evaluate the degree of success to-date. Local authorities co-operate on a wide array of activities bi-laterally, through the Municipal County Unions, or even with counties and the central government. These can range from cultural events and the promotion of tourism, to large, high-cost infrastructure-based services such as water provision, waste management, and public transportation. Organisational modes vary, ranging from non-profit associations of all the municipalities within a county; the establishment of a private company where the shareholders are the various co-operating Municipal Councils; joint-owned companies with NGO status; a joint stock company with

partial private ownership. In addition, some municipalities share administrative costs for certain professional specialists (*e.g.*, architects or building inspectors). Ultimately, it may not be a question of co-operating sufficiently, but rather a question of co-operating effectively, as current co-operation levels might not be making the necessary difference in building a critical mass and increasing capacity. This could be due to a narrow scope of co-operation within each area. For example, there seems to be little sharing of administrative costs through joint purchasing or educational co-operation through building networks to support teacher professional development within an area. It could also be due to the fact that individual municipalities remain small, despite co-operating bi-laterally, tri-laterally or even wider, and for specific services the mass reached may still be insufficient to realise the necessary gains.

Despite all this activity, inter-municipal co-operation in Estonia is not systematic and lacks clear support from the central government (see Box 6.3). Successful co-operation seems to depend on historical ties and relations between decision makers in different municipalities. There is no articulated policy for co-operation, economic incentives are missing or not realised, and the difficulties arising from the global financial and economic

Box 6.3. **Building municipal co-operation in social services: The case of the Seto County area**

Effective inter-municipal co-operation in Estonia can be dependent on numerous factors, such as strong leadership and capacity building, including in the form of external guidance. This is illustrated by the co-operative initiative of a cluster of four municipalities in Southeast Estonia's Seto County area. Despite commonality in terms of tradition and culture, and an identified need to improve the delivery of public services, these municipalities were not collaborating. Behind this fragmentation, such barriers as a lack of trust and a history of conflictual rather than co-operative inter-municipal relations were identified. In addition, there was a lack of knowledge and experience among the municipalities in terms of how to co-operate, and difficulty in involving diverse stakeholders in planning processes. Capacity-building mechanisms were also lacking particularly from potential government partners such as those at the central level.

Upon the initiative of one municipal leader, the municipalities and the county municipal union began to discuss what could be done to improve the service delivery situation, eventually focusing on areas where youth and elderly care services could complement one another. In order to overcome a capacity deficit, these municipalities did not turn to the central government or to the national municipal associations. Rather, they worked together to apply for Norwegian financial assistance in order to hire an external consulting group that could analyse the relevant work being undertaken in the municipalities. The project eventually focused on three areas: 1) youth work; 2) cultural co-operation; 3) elderly services-domestic care. The consultants analysed services and customer satisfaction, service accessibility, problems and challenges faced – and developed a questionnaire which was sent to 6% of the total population. They also interviewed youth, cultural, and elderly-care workers. The results were used to develop a list of ideas for increasing efficiency in these service areas, which was then presented to the municipal leaders who prioritised the options and set a timeline. Once these were established, the consulting firm would then work with the municipalities on implementing the various solutions accepted.

Source: OECD interviews.

crisis are not sufficient motivators to provoke greater co-operation. Compounding the problem is the method of EU fund allocation, which is competition based and thus pits municipalities against each other rather than being used as an incentive mechanism for large scale co-operation in a sustainable and strategic fashion.

Voluntary co-operation in Estonia may not go much farther without direct guidance or financial incentives from the central government, including the possibility of making the decision centrally as to which services should be undertaken co-operatively. This could be in the form of laws or legislation that require co-operation in specific instances, as implemented by the Netherlands. The Dutch Law on Mutual Agreements regulates the co-operation between municipalities, provinces and other sub-national public bodies. In principle, the co-operation is voluntary; however, under certain conditions and procedures, the national government can force sub-national authorities to co-operate for a well-defined public cause of great importance (Charbit and Michalun, 2009). It could also be mandating a particular population level (a catchment area) for the provision of a specific service, as with both hospitals and vocational training in Finland. Through its Act on Restructuring Local Government and Services (PARAS) Finland stipulated that a 20 000 inhabitant-base was required for the provision of primary healthcare and other closely linked services. It was up to the municipalities to decide if they wished to merge to reach this figure or to create joint-cooperative bodies (OECD, 2010f). Another alternative would be to undertake a similar exercise as Luxembourg in establishing what might be a population threshold for municipalities in order to ensure that all municipalities are delivering a basic set of required public services. The last two alternatives require calculations for establishing population bases and the cost of producing and delivering specific services overall and per person. Significantly, these calculations are highly country- and objective-specific.

Additionally, a locally decided combination of own production, joint provision and contracting out may give municipalities the possibility of addressing economies of scale or service spillovers on a service-by-service basis. This approach could help municipalities find the most flexible and locally appropriate way to organise their services. If single or multiple purpose organisations are used, it is important that decision making is in the hands of elected officials to guarantee accountability, transparency and better preference-matching of the co-operative organisations. A practice where the decision-making bodies of the organisations are formed of nominated civil servants or politicians should be avoided.

If Estonia pursued a co-operative model that required establishing a catchment area or a population threshold, it could build a democratic element by involving municipalities in the decision of how they will accomplish the mandate. Incentives should be built in, as well as sanctions for non compliance. A trial period with clearly established timeframes and objectives should be considered to determine the success of the co-operation. If there is low co-operation, or if the expected gains (*e.g.*, citizen satisfaction, quality, efficiency and effectiveness) are not realised, it would be worthwhile to consider mergers.

"Integrated" co-operation (mergers) as a means to build scale and capacity

Given the population and demographic challenges, it is striking to note that the issue of scale has not been successfully addressed in Estonia. This is in contrast with Nordic countries, for example, which have already reformed or are in the process of reforming their municipal structures through municipal mergers and re-consideration of service tasks between different government levels. Such reforms have been undertaken with the expectation that they will lead to the further reform of service structures, as municipalities

are forced to reconsider their organisation, service standards and administrative routines after implementing a merger.

Countries approach mergers in various manners, ranging from voluntary to mandatory (or almost mandatory) with a specific target size, as most recently seen in Denmark (see Box 6.4). Mergers face an "acceptance challenge", however, and can be a politically charged option (Charbit and Michalun, 2009). Many municipalities argue a loss of identity; a loss of democratic representation; and a loss of funding. There are also arguments that if two weak municipalities choose to merge, it will not necessarily result in one strong one, but rather one large weak one. Despite these arguments, mergers remain a viable mechanism with some evidence of economies of scale associated to specific services (*e.g.*, schools and hospitals) as experienced by Finland and Denmark (OECD, 2006c).

Box 6.4. **Sub-national reform in Denmark**

On 1 January 2007, after a four-year reform process, the number of Danish municipalities was reduced from 270 to 98, with an average size of 56 000 inhabitants; the number of counties fell from 15 to five. After a series of public hearings and discussions in the second half of 2004, all Danish municipalities were asked to select the neighbouring municipalities with which they wanted to merge. The threshold size for the new municipalities was set at 20 000 inhabitants. The deadline for selecting partner municipalities was 1 January 2005, two years prior to the actual mergers. Thirty-two municipalities (located largely around Copenhagen) remain the same as in the past because their total inhabitants exceeded 20 000 and so they were not obliged to merge. Between mid-2004 and the end of the year, municipalities negotiated with potential partner municipalities, and citizens were given the opportunity to articulate their preference through a series of local referenda. Municipal amalgamations were voluntary in the sense that the municipalities were able to choose their partners. The central government had the possibility to intervene in cases where voluntary agreements could not be reached. Ultimately, however, the central government intervened in only two cases. The primary goal of the merger process has been to improve the quality of municipal services by transferring new responsibilities from the county level to municipalities and by increasing their size, to ensure that they can assume these new responsibilities, which include environmental control, adult education and specialised social services. Municipalities will also transfer responsibilities for assessing and administering taxes to the national level. Efficiency concerns were also among the reasons that municipalities were merged. It assumed, for example, that the new municipalities will benefit from economies of scale. However, this consideration was generally secondary to the larger concern regarding the quality of service provision.

Source: Charbit and Michalun (2009), "Mind the Gaps: Managing Mutual Dependence in Relations Among Levels of Government", *OECD Working Papers on Public Governance*, No. 14, OECD, Paris.

Experience has shown, however, that mergers are hard to accomplish – particularly on a strictly voluntary basis. Such voluntary-based reforms take longer to process, can be very costly, and require strong guidance from the central government. There are other difficulties to contend with as well, including problems of local competence and of local resources. In the first case, while some believe that amalgamation leads to potential economies of scale, others argue that whether cost savings are realised depends largely on the quality of the local public administration. Larger size requires new local capacity, which takes time to be built. In the second, potential cost savings of mergers are sometimes obscured by the fact that new

responsibilities have accompanied the creation of large merged local authorities (particularly cities) without corresponding resources (OECD, 2005a).

The main practical limits to mergers have to do with inertia in local identity. Municipal consolidation is "popular" with senior civil servants and those working for higher levels of government. Reluctance is expressed essentially by local elected representatives and municipal inhabitants. From the citizen's perspective, there is a fear of losing a certain quality of life which they ascribe to "local identity" (OECD, 2005a). In general terms, such a divide between the central and local perspectives is also seen in Estonia, though there is variance of opinion at the senior central levels as well. Significantly, this lack of consensus at the central level appears to be one obstacle preventing policy development and implementation in this area. One argument in the literature established against merged structures is that they increase the distance between local authorities and citizens, resulting in lack of control over elected representatives (OECD, 2005a). This may be another obstacle in Estonia, where the size of municipalities permits many residents to be linked to the activities of the municipal council through various committees.

The results associated with Estonia's 2004 Promotion of Local Government Mergers Act[10] have been spotty. There are examples of success, such as Tapa municipality (see Box 6.5), but there are also situations of stagnation in merger discussions. The results associated with the Act may be due in part to the fact that objectives and parameters were not clearly established *(e.g.,* a total number of municipalities in the territory at the end of a fixed time period), and that incentive mechanisms established are few and low: a "one time" EEK 2-4 million (approximately EUR 128 000-256 000) payment, depending on the number of residents in the merging municipalities. There is, however, a ceiling on these additional

Box 6.5. **Experience with municipal mergers in Estonia: Tapa municipality**

Tapa municipality is one of the few municipal merger success stories in Estonia. In 2005, three municipalities – Lehtse, Saksi and Tapa – completed merger negotiations to form one new municipal entity: Tapa municipality. With a total of 8 710 inhabitants in 2010, it placed among Estonia's 25 largest municipalities in terms of population. Official merger discussions began in 2003, though the three communities had been exploring the concept since the early 1990s. In order for the merger to work, issues of cultural identity had to be overcome, as well as those concerning administrative boundaries as the municipalities destined to merge straddled two counties. Particularly for this last matter, the communities worked with the central level (primarily the Ministry of Interior/Regional and Local Affairs).

Tapa created a governance structure for the merger process that established a reform committee comprised of the mayor and one council member from all merging municipalities. In addition, five to six working groups were set up. The merger process in Estonia follows similar lines regardless of municipality: 1) the concerned councils must agree on the process; 2) citizens vote whether or not to merge in a referendum; 3) the concerned councils take a final decision to merge or not. Generally, councils follow the referendum results. Tapa municipality was also very bold when establishing the governance structure of the new municipality: in order to maximise the possibility of efficiency gains through a more streamlined administration, Tapa chose to create a new public administration instead of trying to fuse those of the original three municipalities. After significant debate, it was also determined that elections for a new municipal council based on one electoral region (*i.e.,* the new municipality) rather than three would be most effective in the long run.

Box 6.5. **Experience with municipal mergers in Estonia: Tapa municipality** *(cont.)*

EU funding was one of the motivating forces for completing the merger: it was clear to the municipalities concerned that they would be eligible for larger grants and co-financing if they joined forces. Among the factors that made the merger successful were that Tapa, the largest of the three municipalities and the one with the most economic activity, was physically located between the others – placing it in the centre and not on the periphery – facilitating access to services and economic activity. Service points were established in former municipal centres; over time, however, these are less frequently used as citizens become more accustomed to going to the municipality's centre. Citizen engagement was taken into consideration, illustrated by the fact that citizens and municipal councils were presented with a plan for the re-organisation of public services, as well as an associated investment proposal. In addition, communications campaigns were developed to inform residents about the merger process and municipal structure; to answer questions and to provide insight into how public services would be affected. Perhaps the most important success factor was that the municipalities pooled resources in order to invest in the process. This included hiring management consultants to help plan the municipal organisation, which served as a basis for the new internal administrative structure. This indicates that municipalities which are unable to invest as a means to build their capacity for designing and implementing a merger will have difficulty undertaking or completing the process successfully. The result of the merger, according to former Tapa officials, was more money available for road management, to renovate municipal buildings including schools and libraries, and more effective management of public services including education.

The Tapa experience also illustrates that voluntary mergers can be slow: the three municipalities had been discussing a merger since the early 1990s but were unable to complete the process until 2005; they require investment and capacity: the merging communities pooled resources and invested in an outside consulting group to fill a capacity gap; municipal leaders and local public servants need courage, foresight, and an ability to set their personal interests aside when creating a new municipality with a new council and municipal administration, particularly if administrative efficiency gains are an objective. Finally the experience highlights the need for a common purpose, here the realisation that by co-operating the municipalities would be in a stronger position to receive EU funding for projects if the projects were to serve one relatively large base than three small ones.

Source: OECD interviews.

funds. This could be compared to the stepped, declining and temporary incentive structure built into Finland's PARAS model, where financial incentives to merge are higher the earlier the decision is taken and the higher the population figures of a municipality post-merger (see Box 6.6). For those municipalities that merged, the incentive structure was significantly greater and more complete in its development than that seen in Estonia.

Given the municipal resistance and administrative challenges associated with mergers, many countries are taking a flexible approach to building scale. In its proposed administrative reform, Luxembourg outlined a "hybrid" approach to reach the 3 000-3 500 inhabitant criteria for a Basic Level commune. Horizontal co-operation could be realised taking several paths. One would be mergers. Luxembourg has in place a framework for voluntary mergers with substantial financial advantages (EUR 2 500 per inhabitant for merged communes). However, merger activity has been low over the years (OECD, 2007c). Thus, another option considered

Box 6.6. **The Finnish PARAS Municipal Reform: Incentives and structure**

The PARAS reform – embodied in the Act on Restructuring Local Government and Services – gives Finland's municipalities the option to either voluntarily merge or to establish partnership areas in order to reach a minimum 20 000 inhabitant base for the provision of social services such as primary healthcare and closely linked services, and 50 000 inhabitants as a basis for an area to provide vocational education training.

There is a stepped, declining and temporary incentive structure built into the PARAS model, whereby fiscal incentives are higher the earlier the decision to merge is taken and the higher the population figures of a municipality post-merger. For example, in 2008-09, if the total number of municipalities reduced by a merger is three, creating a single municipality of over 20 000 inhabitants, and if the combined population of the two smaller municipalities deciding to merge is over 10 000, then the municipal merger grant will be EUR 9.72 million. However, if these same three municipalities chose to merge in 2012-13, then the grant falls to EUR 5.4 million. There are no explicit merger targets set in the PARAS reform – *i.e.,* no target of inhabitants for a new municipality; no target number of municipalities – and no explicit time by which mergers have to be completed, though the incentive programme runs only from 2008-13. While the mergers are voluntary, in the case of municipalities facing severe economic difficulties, a clause in the Act permits the government to propose a merger without consent from Parliament. There are a few municipalities in this situation, in Lapland for example, though the government has not used this option to date.

Because mergers are voluntary but catchment areas for service provision are not, the other option available to municipalities is the establishment of partnership areas. These constitute a functional entity rather than an administrative one (as in the case of merged municipalities). Municipalities are free to select with which neighbours they wish to establish such partnership areas, and can enter into as many agreements as they wish. Therefore, a partnership area may be organised among three municipalities for the provision of elderly care. It is conceivable, however, that these same three municipalities do not co-operate for primary healthcare. They may co-operate with other neighbours for providing this service.

By 2010, the number of municipalities has been reduced from 415 to 342. In 2011, three mergers involving nine municipalities are expected; and in 2013 at least one merger is expected involving two municipalities. Less than halfway through its implementation phase, it is too early to measure the results associated with this reform.

Source: OECD (2010), *OECD Public Governance Reviews: Finland: Working Together to Sustain Success*, OECD, Paris.

would be to build minimum numbers through non-integrated co-operation, as in Finland and France. This would be achieved either by mandatory co-operation where central aid is granted on the condition of municipal co-operation and by making the aid essential for the communes to function properly; or by providing incentives through subsidies that are much higher if a commune belongs to an inter-communal co-operation establishment modelled after the French *Établissements publics de coopération intercommunale* (EPCIs) (see Box 6.7). Here, the first step is establishing support on a scale that provides a large enough incentive for communes to opt to co-operate (OECD, 2007c), which has not been the case in Estonia thus far. The next step is to ensure that the EPCIs-like organisation established can benefit from supplementary resources (particularly fiscal) to finance the responsibilities that have been assigned to them (OECD, 2007c). In Estonia, the County Municipal Unions are the bodies most akin to the EPCIs, but they may not be currently operating on the scale required to affect

Box 6.7. **Municipal co-operation: The case of France and EPCIs**

France is characterised by voluntary co-operation at the local level. It has more than 36 000 communes (the basic unit of local governance). Although France has resisted municipal mergers, the need for local co-operation is clear. As such, the communes are united by approximately 19 000 inter-communal structures (which includes 2 525 EPCI and other forms of syndicates) aimed specifically at facilitating horizontal co-operation.

The current system of inter-communal structures was first established in 1992 and reformed in 1999 such that there are now three main types of supra-communal structures: communities of communes (groupings of small rural communes), "agglomeration" communities (groups of 50 000 inhabitants subject to a single business tax), and the urban communities (groupings of 500 000 inhabitants or more). "Single purpose inter-communal associations" ("syndicates") first established in 1890, and multi-purpose syndicates, which date back to 1959 are also still in existence.

Each grouping of communes constitutes a "public establishment for inter-communal co-operation" (EPCI). The EPCIs assume limited, specialised, and exclusive powers transferred to them by member communes. Unlike the communes themselves, the EPCI is not governed by elected officials but by delegates of municipal councils. This essentially shifts power away from elected officials to civil servants in the areas of competence ceded by the municipalities. Although the EPCI are created by the communes directly, there are two notable roles for the central government. First, EPCIs must be approved by the State in order to exist legally. Second, to encourage municipalities to form an EPCI, the central government provides a basic grant plus an "inter-communality grant" to those communes that accept a single business tax, which is established to preclude competition on tax rates among participating municipalities in order to attract business. EPCIs draw on two sources of financial resources: budgetary contributions from member communes (for the syndicates) and/or their own tax revenues (for the EPCIs).

There are some indications that inter-communal co-operation has produced efficiency gains. On the one hand, some outdated governance structures disappeared after the 1999 reforms and communes tend to collaborate in areas such as public works, which are likely to exhibit economies of scale. On the other hand, growth in inter-communal spending has not been accompanied by a decline in communal spending, transfers of personnel from communes to communities are associated with a rise in payroll costs and local tax increases, and the presence of communal and inter-communal governance structure results in overlaps and extra costs. Overall, however, measuring the efficiency and effectiveness of municipal co-operation is difficult in France, as there is no culture or institutional structure for evaluation of public policies in this regard.*

* See Cour des Comptes (2005), "L'intercommunalité en France, rapport au Président de la République", novembre, *www.comptes.fr/cour-des-comptes/publications/rapports/intercommunalite/rapport.pdf*.

Source: Charbit and Michalun (2009), "Mind the Gaps: Managing Mutual Dependence in Relations Among Levels of Government", *OECD Working Papers on Public Governance*, No. 14, OECD, Paris; the complete source originates from the workshop presentation by France; OECD (2006), *Territorial Review of France*, Extract submitted for the workshop, OECD, Paris; Hernu, P., "Co-Operation Between Municipalities in France: The Search for Greater Effectiveness of Public Action at the Local Level", Chambre régionale des comptes du Nord-Pas-de-Calais (submitted for the workshop).

change, and their particular non-profit legal status does not permit them to benefit from supplementary (state-level) grants or subsidies.

Should Estonia decide to retain the system of voluntary mergers, it ought to consider a new incentive structure. For example, a special merger grants programme could be

envisioned, more generous than what is currently in place, and emphasising mergers of multiple municipalities. The grants programme would need to be coupled with a time limit, and in return for the grant, municipalities should not only agree to improve their efficiency, they should provide a plan as to how they foresee this can be done. As an additional financial incentive, the equalisation system could be altered, for example, by increasing the role of general per capita grants (the same value per capita), or by reducing the degree of equalisation. To facilitate discussions, an external administrator could be assigned to municipalities (for example by the central or county government) in order to consult and guide the process. The cost of this administrator should either be absorbed by the central government or shared between the central and local authorities. Results achieved by merged municipalities under this programme should be carefully evaluated during and after the programming period.

However, if Estonia is serious about increasing municipal capacity for service delivery, it may need to think about a system of mandated "semi-voluntary" mergers, particularly as the benefits from non-integrated co-operation may be stagnant. This means that the government mandates mergers but gives municipalities the opportunity to present proposals for "merger" partners that are coherent and do not create a "Swiss cheese" effect. This is similar in concept to the Danish approach.

Another alternative which can be used to build a business case for co-operation, as well as capacity, is to develop regional experiments. Experiments at this level can be undertaken for various purposes. Experimentation in policy design and implementation can serve to promote co-ordination and build capacity thanks to partnerships among the local areas concerned. Pilot programmes are another example of experimentation which can also promote innovative solutions. In the US for example, the Department of Housing and Urban Development used a pilot phase to test a new approach to monitoring formal grants administered by the Office of Community Planning and Development. The approach was tested in eight locations of the country. Regional forums allowed stakeholders to provide feedback in the pilot phase before the full system was rolled out in 2006 (OECD, 2009e). In Finland, the Kainuu Regional Experiment was established for experimenting with both efficiency in service delivery, as well as directly elected regional government. In Sweden, regional experiments have been used with respect to building larger county-level administrative areas. Pilot projects can also help identify the good practices that lead to the success of an initiative, and provide early insight into the challenges that could be faced when a programme is more widely implemented. In this way, efforts can be made to help build capacity before a capacity deficit becomes detrimental to the accomplishment of objectives (Charbit and Michalun, 2009). Estonia has solid experience with pilots at the central level, making use of the networked relationships among its civil servants. It may wish to identify ways to incentivise pilots at the sub-national and particularly local levels.

Estonia may lack a suitable mass of activity for re-distributing some service delivery responsibility to a higher level (*i.e.,* county) of government. This does not, however, preclude the development of broader-based partnerships using either the existing county governments or the County Municipal Unions. This could take the form of experimenting with larger co-operative areas of a particular scale (*i.e.,* a catchment area) for a pre-determined set of services *(e.g.,* education, social services, business development, infrastructure development and maintenance) through a contractual agreement among municipalities and with a co-ordinating body *(e.g.,* the County Municipal Union). Depending on objectives and design, such an experiment could provide an opportunity for: *a)* municipalities to learn to work

together better; *b)* actors to determine if scale in terms of population makes an impact on resource capacity and the provision of services; *c)* identifying if in the Estonian context single-purpose or multiple-purpose co-operative bodies are more appropriate; *d)* the Government to introduce performance measurement and quality standards through the contractual arrangement, and increase the comfort level with contracts as a co-ordination mechanism. It might also provide a means to test new ways of allocating EU funds, moving away from project-based competition to programme-based co-operation.

Many, if not most, OECD countries face challenges in service delivery due to municipal scale. The approaches, implemented or proposed, of the three countries presented here – Denmark, Finland and Luxembourg – could be of value to Estonia. One option would be to follow a Danish "top-down" approach with a democratic element that permits municipalities to select merger partners. Another path is that which has been followed by Finland,[11] and proposed by Luxembourg: voluntary mergers complemented by options for horizontal co-operation in order to arrive at a cost-effective scale.

In light of the reticence to co-operate between neighbouring municipalities based on fears of a loss of identity, of greater unemployment, local political interests, etc. – combined with a lack of consensus at the highest levels of government, and low capacity to promote and manage sub-national reform centrally and locally – it is not surprising that attempts at such reform have not been terribly successful to date. The lack of incentive for voluntary horizontal co-operation, and the weakness of the current policy for voluntary mergers combined, do not withstand the diverse obstacles, some of which are based on values and beliefs which take time to change. The result, however, is impacting the financial sustainability of municipalities and their ability to competently deliver quality public services in an effective and efficient manner.

Focusing strictly on building scale as a means to address demographic, economic, social and service delivery problems at the local level may be limited in scope. Estonia may wish to establish strong structural and incentive mechanisms under which non-integrated voluntary co-operation among municipalities becomes the *de facto* alternative to the existing option of voluntary mergers. Mandated mergers, as practiced in Denmark, with a democratic element could be a next step when co-operation does not yield desired results based on clearly stated, communicated and measurable objectives *(e.g.,* municipalities with a specific population size, as in Luxembourg, or service catchment areas for a specific population size, as in Finland).

Regardless of the horizontal co-operative approach – non-integrated, integrated or a combination – a clear policy for building scale should be established, articulated and communicated. It should have well-defined and stated objectives, and should link back to territorial goals and regional development policy. In addition, it ought to be combined with a re-evaluation of the service delivery expectations placed on municipalities.

Reconsidering the status of Tallinn City

As Estonia's most important urban centre, the productivity contribution and public services associated with Tallinn and its surrounding areas are significantly different than the remaining municipalities. (These include challenges of traffic congestion, population density, environmental degradation, influxes of tourists, etc.) Currently Tallinn is classified as all other Estonian municipalities. It does not have special status of as a "capital city" (though it is the capital of Estonia); nor is it plus its surrounding area (Harju County) classified as a

metropolitan region. Tallinn and its surroundings, however, face similar challenges as metropolitan regions in other OECD countries, including (OECD, 2004b):

- *The fragmentation of administrative jurisdictions within metropolitan areas* which results in a lack of correspondence between administrative and functional territories. As major cities of OECD countries expand geographically outward, old administrative boundaries usually remain in place, creating a patchwork of municipalities within the urban area, each with its own vested interests to defend. This creates a complex policy environment in which area-wide consensus on medium- and long-term goals in environmental quality, economic development and competitiveness, social cohesion, equitable public finance and the level and quality of public services across the urban region is difficult to reach.
- *Increasing strain on the financial/fiscal ability of local authorities* in metropolitan areas who face additional charges at a time when economic and social conditions have deteriorated for many segments of the population, and when major investments in infrastructure are required to enable metropolitan areas to compete in the global economy. In many countries, decentralisation has produced unfunded mandates, *i.e.,* upper levels of government downloaded responsibilities to the local level without introducing corresponding, but politically difficult, financial and fiscal reforms. The reform of urban public finance is lagging behind the institutional changes in metropolitan areas.
- *Lack of policy co-ordination.* Controlling urban growth on a metropolitan scale implies strong inter-governmental policy co-ordination. For example, urban sprawl engenders heavy costs for central governments in terms of infrastructure and amenities, but it is, on the other hand, a new revenue resource for suburban municipalities that rely strongly on income or property tax. Although it could be more profitable to concentrate certain industrial activities within the central city, suburban jurisdictions would still like to benefit from the revenues stemming from firms located in their jurisdiction. Confronting national, sub-national and local priorities in terms of economic development and limiting urban sprawl in metropolitan areas have thus become real challenges for every level of government.

In addressing these challenges, metropolitan governance reforms have varied across OECD countries (see Box 6.8).

Box 6.8. **Main trends in metropolitan governance in OECD countries**

Confronted with the new challenges of globalisation, decentralisation and metropolisation, OECD countries are experimenting with a variety of institutional metropolitan solutions to achieve greater policy coherence, to reduce internal disparities and to enable the efficient delivery of public services across metropolitan regions. The different approaches developed in the following typology are not mutually exclusive, as some metropolitan regions combine several of the following aspects.

1. The *status quo* is an option which rarely yields positive results and is often surrounded by a long-term discourse on reform

Relying on the assumption of mobile citizens, competition between jurisdictions may provide incentives for governments to raise public sector efficiency. However, experiences in Western Europe or North America show that fiscal competition may lead to declining or less cost-efficient services and wasteful rivalry between areas.

Box 6.8. **Main trends in metropolitan governance in OECD countries** *(cont.)*

2. Intermediary solutions include all forms of horizontal collaboration ranging from metropolitan-wide fiscal arrangements to the creation of metropolitan single- or multi-purpose agencies

Purely fiscal measures have been a preferred approach in many OECD countries. Metropolitan-wide fiscal arrangements could be undertaken by the national government, such as equalisation programmes in Sweden, or emerge as a horizontal collaboration initiative, like a tax-base sharing programme (Minneapolis-St. Paul, USA).

For pragmatic reasons, sectoral agencies have been created to operate metropolitan-wide public services such as transport (SEPTA in Philadelphia, USA; Strathclyde Passenger Transport Executive in Glasgow, UK). These agencies are generally financed by farebox, contributions from member municipalities or complementary sources. More expansive are some horizontal institutions similar to the Montreal Metropolitan Community (CMM) that play the role of co-ordinating and planning bodies at the metropolitan level and thus are multi-purpose agencies. Their responsibilities range from transport, police, fire and emergency planning, economic development, culture, environment and health (Greater London Authority in the UK) to parks, land use, waste disposal, recycling (Metro Council of Portland, Oregon, USA). Often composed of directly elected officials, they can sometimes levy their own taxes *(e.g.,* the Metro Council of Portland gets 14% of its USD 200 million budget from levying a property tax) but also rely on contributions from their member municipalities (54% for the Stuttgart Regional Association in Germany), inter-governmental grants (most of the GBP 49.9 million cost for the Greater London Authority in the UK) or user fees and charges of metropolitan-wide operated firms (in Portland, for example, more than 50% of the Metro Council's budget comes from the solid waste disposal plan, the zoo, the Convention Centre, the Expo Centre and the Portland Centre for art performances).

3. Informal metropolitan governance

Instead of creating new metropolitan-wide institutions, some OECD countries have sometimes adopted original solutions relying on pre-existing institutions that ensured *de facto* the informal governance of a metropolitan area. For example, the *Comunidad Autónoma de Madrid* progressively imposed itself as a "meso" government with administrative boundaries that correspond to the former province of Madrid. In other cases, new regulatory mechanisms emerged from city networks that spontaneously filled in the institutional blank and ensured free dialogue and co-operation among the cities in the metropolitan territory. This light form of metropolitan governance contributed, for example, to the development of a Greater Lyon in France.

4. Radical solutions are also in evidence…

… whether they be large scale re-organisation including amalgamation and the abolition or creation of metropolitan government (London). However, while amalgamation led to the disappearance of municipalities, the establishment of the metropolitan level as a new tier of government does not necessarily lead to the suppression of former local structures.

Source: OECD (2004), *OECD Territorial Reviews: Montreal, Canada*, OECD, Paris.

The functional model of metropolitan governance has been promoted in many OECD countries. It is based on governance at a functional economic-area level, and built around cross-sectoral competitiveness and competences (*i.e.,* not restricted to a specific sector or service) in areas with a metropolitan logic (*e.g.,* transport, housing, investment promotion, water supply, and tourism) apart from the rest. It aims at achieving economies of scale

generated by larger, unified service delivery areas, better cost equality and less social segregation across the entire metropolitan region, as well as more effective strategic planning and integration of sectoral policies (OECD, 2010h).

Structurally, this can take the form of large-scale amalgamations, establishing metropolitan authorities (as seen in Germany with the Stuttgart Regional Association, in the UK with the Greater London Authority, and in the US with the Portland metropolitan district), or promoting inter-municipal joint authorities. The first two options have advantages of building scale and unifying service delivery, for example, but may also dampen competition and public choice, provide only a partial solution to fragmentation, and are often politically not viable (OECD, 2006b).

Inter-municipal joint authorities can either be single purpose or sectoral – *i.e.,* tasked with the delivery of only one service such as transportation – or they can be multiple purpose metropolitan bodies which perform a wide range of functions such as planning and co-ordination and sometimes public service delivery (see Box 6.9). In some cases, not only can they deliver economies of scale in specific policy areas, but can also equalise the sharing of service costs across the metropolitan region and allow for a more harmonious distribution of resources (though the degree of re-distribution is not as systematic as in heavier governance models). The advantages of metropolitan-wide co-ordinating and planning bodies depend on whether they take into account the overall metropolitan area.

Box 6.9. **Examples of multi-purpose inter-municipal bodies in Canada (Montreal and Vancouver) and in France**

In Montreal, the amalgamation of municipalities gave birth to the New City of Montreal, whose boundaries still did not coincide with the functional area as defined by community and regional clusters patterns. Thus, a new regional body called the *Montreal Metropolitan Community* (CMM) was created by the government of Quebec in 2001 to handle responsibilities in areas of land planning, economic development, housing, public transit, environment, and waste management. The CMM has a planning, co-ordinating and financing role and is managed by a council comprised of 28 representative mayors. Its budget (around CAD 118 million) is essentially funded by contributions from member municipalities (roughly 88%) and grants from the provincial government (roughly 12%). The CMM has been particularly active in promoting an economic development strategy for the whole metropolitan area, including the creation of a regional fund, the production of a strategic vision and the elaboration of a cluster strategy, as well as lobbying towards higher levels of governments to get more funding for municipal infrastructure. It provides a rather modest tax base growth sharing mechanism. This programme is used to finance small development projects throughout the CMM and thus would only marginally improve fiscal equity among municipalities.

Canada's Greater Vancouver Regional District (GVRD) is a voluntary organisation that has achieved striking successes in the Vancouver metropolitan region to deal with such challenges as rapid growth, under-investment in infrastructure, and so on. The GVRD is a partnership among the over 20 municipalities that make up the Greater Vancouver metropolitan area, which has formal responsibility for providing metropolitan-wide services such as drinking water, sewage treatment, recycling and garbage disposal, as well as regional planning and environmental protection. It can also choose to take on other roles on a voluntary basis. The GVRD's Board of Directors is comprised of mayors and councillors that serve on members' local councils, on a representation-by-population basis. The budget of GVRD is fairly small

Box 6.9. **Examples of multi-purpose inter-municipal bodies in Canada (Montreal and Vancouver) and in France** *(cont.)*

(CAD 191 per capita in 2002, compared to CAD 1 135 per capita for the lower-tier municipalities combined). The largest expenditures of the GVRD are for water and sewers (42% of total in 2002), capital expenditures (23%), and solid waste management (16%). User fees account for 80% of GVRD revenues followed by property taxes (almost 8%), and other investment income (almost 5%). A separate regional authority is responsible for transport.

Municipal organisation in France is characterised by fragmentation, which has led municipalities to develop pools for certain services. This form of collaboration has always been practiced on a voluntary basis and is regarded by some as an effective alternative to grouping local authorities. In the late 1990s, the government decided to recognise the concept of agglomeration to clarify the institutional framework and accommodate the proliferation of agreements and actors. With the introduction of three laws (law on spatial planning and sustainable development or LOADDT, law on strengthening and simplifying inter-municipal co-operation, and law on urban solidarity and development or SRU), the government developed a mechanism to encourage the creation of *agglomeration communities* (a public inter-municipal co-operation body for urban areas of over 50 000 inhabitants grouped around a central city with at least 15 000 inhabitants) and the *urban community* (a public inter-municipal co-operation institution for urban areas with over 500 000 inhabitants). As of 2005, there were 143 Agglomeration Communities and 14 Urban Communities. These joint inter-municipal bodies are directed by councils composed of representative municipalities and carry out such functions as spatial planning, economic development, public transport, environment, social housing, waste disposal, etc. Generally the president of the board is the mayor of the central city. To carry out most of their responsibilities these authorities enjoy their own tax revenues from the establishment of a common business tax. In addition, they receive some financial assistance from the State through an increase in the operating block grant (*Dotation globale de fonctionnement*).

Source: OECD (2006), *OECD Territorial Reviews: Competitive Cities in the Global Economy*, OECD, Paris.

Estonia may wish to re-evaluate and adjust the governance structure for Tallinn and its adjacent municipalities to one that is more functionally driven, in an effort to address the governance challenges associated with metropolitan areas. This could help ensure that the local services delivered and the methods for delivery match citizen needs according to municipal typology, capacity and need. A special status for Tallinn (or the Tallinn City + Harju County region) could increase the capacity to manage co-operative service delivery across municipal boarders. Doing so could mean creating metropolitan government authorities, as was done in London and Stuttgart, or it can take the form of an inter-municipal joint authority, possibly using existing County Municipal Unions as a basis. Regardless of form, the matter is not only related to service delivery; it also has a regional policy dimension, and thus should also be treated within the rubric of regional development policy.

Supporting innovative service delivery for efficient, effective and accessible public services

The various forms of co-operation already discussed recognise the limits of individual public sector entities (*e.g.*, government bodies or local authorities) to single-handedly deliver both joined-up services and the level of innovation required to make those services high quality, accessible and sustainable. Improving service efficiency and effectiveness will

therefore require not only improved inter-government co-operation, but also working with other partners for the delivery of public goods, *e.g.,* through co-production, as well as listening to citizens and other stakeholders to understand what they need and value, to get feedback on public services, and to gain insights about how to further innovate on and improve service delivery.

Improving service efficiency through one-stop shops and consolidation

Like all countries, Estonia is looking for innovative ways to reduce central government administrative costs at the sub-national level, while also improving performance. It is approaching this at the "back-office" level, as well as through a more publicly visible experiment. In terms of organisation of the back office, a county government administrative services project initiated by the Ministry of Interior/Regional and Local Affairs has consolidated the accounting and personnel functions of all counties into a central location outside of Tallinn. This has reduced administrative staff and costs at the county budget level.

Estonia can also work to improve the overall efficiency of service delivery, in particular in rural and remote areas. A broad set of possible strategies include aggregating demand through consolidation, co-location or merging similar services. Lääne County's State House project, for example, is being implemented as an experiment sponsored by Lääne County and the Ministry of Interior/Regional and Local Affairs with co-financing provided by the Ministry of Finance. This concept is an example of co-location for central-level services. The aim is to increase citizen focus in service provision, to improve the accessibility of state-level services, and to rationalise the use of state real estate at the county level. It can lead to cost savings as basic overhead costs are pooled, creating economies of scope. It also benefits the user, particularly those who incur travel costs, as they can combine trips, saving money and time. A more local-service example would be combining postal services with a shop so that people in more remote areas can obtain their mail and purchase food in one trip (OECD, 2010i). Box 6.10 provides some additional examples. Merging services, for example several weak local newspapers, can benefit both citizens and the businesses themselves.

The Lääne County State House project creates the possibility of merging local State representation *(e.g.,* ministries, agencies, foundations, etc.) into one physical working environment, including the harmonisation of IT systems and public service practices. This is also a good example of a cross-sectoral, vertical initiative to improve the co-ordination, function and provision of central government services at the sub-national level. It is an initiative that could be considered for implementation in other counties.

Alternative delivery mechanisms should also be considered. This includes bringing services to users, such as through mobile service delivery approaches *(e.g.,* libraries, dental services, basic medical care), or via the Internet. Finland uses this approach with mobile medical units for emergency medical services in remote or distant areas. Occasionally, creating a new service is also a viable option.

Improving service standardisation and back-office functions, and then grouping the State's sub-national activities into fewer centres across the country (either under one roof or housed in proximity) could bring greater coherence to the system (see also Box 6.15). The State House concept may also provide a model for future integration of county functions into fewer administrative areas. This may be a way to introduce coherence and manage the scattered and *ad hoc* fashion in which ministries and their agencies have established themselves across the territory. This action by the ministries, while potentially

Box 6.10. **Multi-service centres for rural populations**

Variants of One-Stop-Shops (OSS) are visible across OECD Member countries. For example, the Rural Transaction Centres (RTC) Programme in Australia helps small rural communities establish locally run and self-funding centres that either introduce new services or bring back services that were no longer available. Since its introduction in 1999, over 200 RTCs have been approved for assistance under the programme. Because a RTC programme field consultant assists in the initial community consultation and feasibility study, the programme considers community needs well in advance and adapts accordingly. Thus RTCs do not compete with other planned services, and usually include: financial services, postal and telecommunications access, federal state and local government services, insurance and taxation, printing and secretarial capacity. These centres employ from one part-time employee to four full-time staff. Funding from the central government covers the capital costs of establishing a RTC and subsidises the operating costs during the early operation stage, if necessary. The RTCs have been integrated into the Australian Government's new streamlined Regional Partnerships programme.

The Finnish equivalent of the OSS is the Citizen Service Offices, which allow for the provision of services (whether public, private, non-for profit or mixed) from a single outlet. The objective is to offer citizens a single outlet for services that are suitable for joint management, *i.e.* municipal district court, tax and work administration, National Pension Institute and other regional and local authorities' services. The services provided include reception and handing out public documents and information, advice concerning the institution of proceedings and processing of matters, and support in the use of electronic services. The aim is to ensure, by means of joint, customer-oriented services and efficient utilisation of information technology, a sufficient and high-quality service network, increase the productivity of the local service network and reduce the cost of service provision.

Source: OECD (2010), *OECD Rural Policy Reviews: Strategies to Improve Rural Service Delivery*, OECD, Paris.

logical for their own activities, makes co-ordination difficult and service provision potentially confusing for citizens. Local or "satellite" offices could be established for citizen services to smooth out the reform in the beginning, and still make use of a portion of the administrative and infrastructure resources. The cost savings of putting services together can be used in part, and for a period of time, to fund the satellite offices. Most likely, it will be seen that after a period these satellite offices will have less use and will eventually close, as experienced at a micro level by Tapa municipality following its merger.

Such consolidation activity has been seen in Finland with the ALKU regional reform that streamlined the regional administrative structure into two types of bodies: six Regional State Administrative Agencies (AVI) and 15 Centres for Business and Industry, Transport and the Environment (ELY). The objective was to boost citizen and customer orientation and to improve efficiency and productivity in regional administration. The initiative was launched in January 2010 (see Box 6.11) and has facilitated organising actors around citizens and strengthening a horizontal approach to public service delivery. Significantly, however, all ministries with regional functions are joined in the effort and are actively involved. They prepare and sign a strategic document to steer state regional level administration.

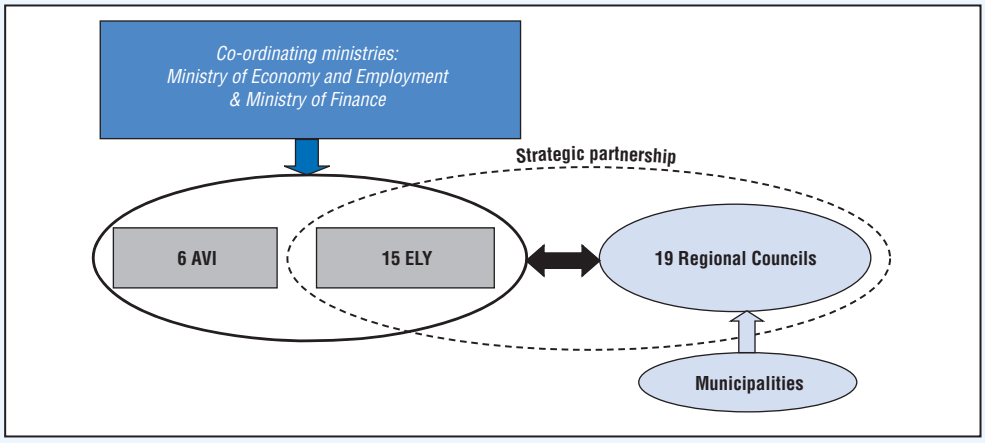
This type of approach – one of merging various entities to create a multi-functional or multi-service organisation – fits within the characteristics and competences of small states: a tendency to merge rather than create specialised state bodies, and a public service that can act in a multi-functional manner, balancing generalised and specialised knowledge. At the

Box 6.11. **Finland's ALKU regional reform programme**

Finland's regional administration reform initiative – *Aluehallinto kehittyy ja uudistuu* (ALKU) – became effective on 1 January 2010. Its objective is two-fold: to enhance co-ordination among regional-level state sector bodies in order to boost their citizen and customer orientation, and to improve efficiency and productivity in regional administration.

The ALKU reform envisions reducing administrative costs by 1 100 person-years by 2015, which aligns with the demands of Finland's Productivity Programme. It streamlines the former deconcentrated state administrative structure of six State Provincial Offices, 15 Employment and Economic Development Centres, 13 Regional Environmental Centres, 9 Road Districts, 6 Occupational Safety and Health Inspectorates, and 3 Environmental Permit Authorities into two types of bodies – Regional State Administrative Agencies (AVI), of which there are six, and Centres for Business and Industry, Transport and the Environment (ELY), of which there are 15. The agencies have varying areas of responsibility (*i.e.,* some are responsible for all three areas of responsibility; others are focused only on specific functions).

ALKU regional administration structure and functions



Source: Adapted from OECD (2010), *OECD Public Governance Reviews: Finland: Working Together to Sustain Success*, OECD, Paris.

administrative services level such consolidation is taking place, for example through the Lääne County State House experiment. However, as noted earlier, at the central level, the opposite seems to be happening, as the trend is for ministries to establish regional ministerial sub-bodies independently and in a fragmented manner (see Table 6.7). Moving towards multi-functional or multi-service deconcentrated bodies can also complement the declining capacity seen with respect to Estonia's county governments.

At re-independence and until 1993, Estonia's counties were a second-tier, elected government. After 1993, county governments became deconcentrated branches of the central government, led by appointed county governors. The governors represent the central government in the county, supported by county government administrations, and are in charge of co-ordinating co-operation between local state agencies. With the *Local Government Organisation Act* of 1994, tasks originally executed at the county level were split among various entities including municipalities, professional associations, national municipal associations and the county municipal unions. The result is that, since 1994, counties have

Table 6.7. **Percentage drops in county administrative staff**

Location	Year	Percentage drop
Harju County	2001-09	45
	2006-09	23
Lääne County	2000-09	43
	2008-10	20
Lääne-Viru County	2000-09	27
	1994-2006	55[1]
Overall national	1999-2009	47

1. Drop in county education staff department.

Source: Ministry of Finance (2001), *Civil Service Annual Report*, Ministry of Finance of the Republic of Estonia, Tallinn; Ministry of Finance, *Public Service Yearbooks* 1999, 2000, 2003, 2005, 2007, Ministry of Finance of the Republic of Estonia, Tallinn; Ministry of Finance (2009), *Public Service in Figures 2008*, Ministry of Finance of the Republic of Estonia, Tallinn.

become less "hands-on" and more supervisory in their role. They are considered to be the supervisors of local government, overseeing schools, healthcare, social services, transportation, and monitoring the legality of municipal activity and locally developed regulations. This, however, appears to be evolving in a rather inconsistent fashion. For example in the field of education, counties were responsible for inspections, though this is no longer the case as schools have moved to a system of self evaluation. At the same time, counties remain responsible for social services, and check both the local government and the service facilities. Currently, the primary responsibility of county governments is to foster county development through their development plans that focus on land-use/spatial planning and social infrastructure. They also play a large role in allocating EU funds to municipalities in their administrative jurisdiction. This shift in degree of responsibility has had an impact on human resource capacity at the county level (see Table 6.7), which further underscores a need consider multi-functional organisations and consolidation options.

Sweden is experimenting with merging counties[12] as a means to promote greater coherence at the regional level. This has been a "bottom-up" initiative based on the positive assessment of two pilot regions. Since 2008, seven counties have applied for a merger (OECD, 2010j). In Sweden, the county structure combines state agencies (County Administrative Boards) with responsibility for co-ordinating and implementing national policies in all counties, as well as some responsibility for regional development with County Councils which are elected bodies, independent of the central government, and are primarily responsible for healthcare (OECD, 2010j). Such mergers have the support of the Committee on Public Sector Responsibilities, as well as local authorities, but support is mixed at the national level.

Lithuania, which resembles Estonia with a single-tier local government and deconcentrated county governments, is considering an even more dramatic approach: eliminating its county governments and either replacing these with a new level of government and four regions, or reducing the number of counties to five (Ministry of Interior Lithuania, 2010; Moisio, 2010b). In Denmark there is a political debate surrounding counties with an idea to eliminate the county level completely and transfer county tasks to separate public bodies, or to the central government and municipalities. This is despite a recent reduction in the number of counties from 15 to five as part of the 2007 local government reform (Blom-Hansen, 2010; Moisio, 2010b).

Serving citizens through e-government and online services

E-Government is a critical tool for establishing a more functional, agile and modern state, and to achieve better service delivery outcomes for citizens and businesses. As shown by the OECD's definition, however, it is essential that e-government work and policy maintain the link between policy objectives and service delivery, on the one hand, and the ICT enabling environment, on the other (see Box 6.12). E-Government can help to maximise the use of limited human and financial resources by supporting the development of innovative capacity, and improving flexibility and responsiveness of the public sector, but it requires an overall vision to stimulate actors to make use of the ICT tools available to them and to collaborate with one another for efficient and effective service delivery.

Box 6.12. **The role of e-government in public administration and public services**

"E-Government is the use of information and communication technologies, and particularly the Internet, as a tool to achieve better government".

Source: OECD (2003), *The E-Government Imperative*, OECD, Paris.

During the 1990s, Estonia established itself as an e-government leader by creating a robust e-government enabling environment and by adopting technological solutions to improve the transparency and efficiency of government. For instance, it was a pioneer in using ICT to enable online voting (used for the first time for local elections in 2005, and for parliamentary elections in 2007) and to support decision making in central government by implementing a secure communications and authentication infrastructure. Estonia set up one of the first paperless briefing and decision-making systems for the Government Council (see Chapter 5: "Building a Common Agenda"). This initiative has been regarded as a best practice by several OECD countries and achieved international recognition as an innovative approach to IT-enabled decision making.

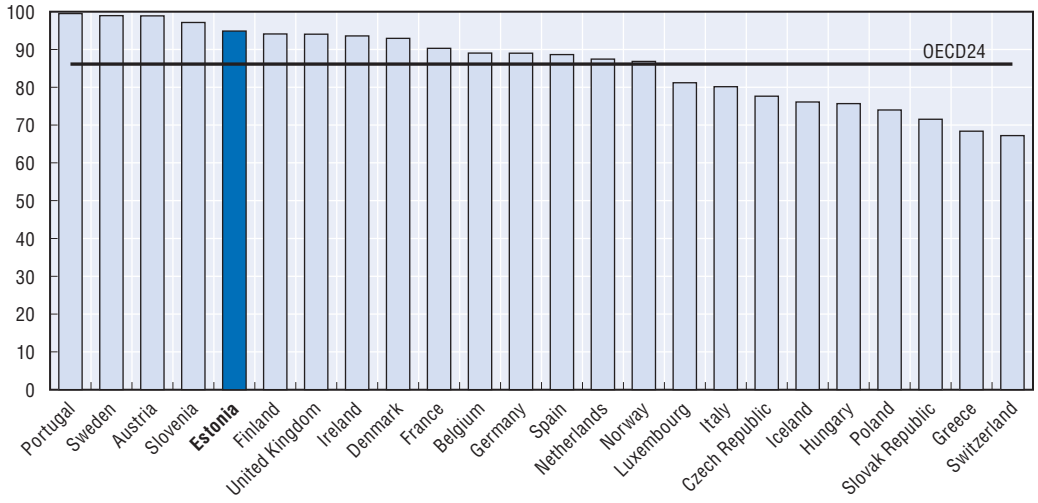
Experience from OECD countries indicates that a well-developed enabling environment *(e.g.,* legislative, budgetary, infrastructure frameworks) is a crucial prerequisite for the implementation of e-government. Estonia has a well-established state infrastructure, including systems and components to support e-government development, similar to those in the most advanced OECD countries, *e.g.* Finland, Norway. This infrastructure – which includes a secure data transport backbone X-Road, different hardware and software components like the state portal, a public key infrastructure (PKI) and governmental databases and information systems – provides the basis for enhanced connectivity across the government.

The high quality of e-government infrastructure, however, is not reflected in a similar high quality across online public services, whose development falls under the responsibility of each sector ministry and local municipality. Such an approach impacts the public administration's overall capacity to develop effective and efficient e-government services at all levels of government.

E-Government services in Estonia include e-health, e-police, electronic voting (e-elections), e-tax and customs services, and the receipt of certain social benefits. The e-ID card enables immediate identification, and facilitates digital signatures according to

the Digital Signatures Act. Citizens furnish data once, and there is a single point of entry for many, if not most, e-transactions. Based on the EU Sophistication Indicator (evaluating a proportion of 20 basic services available online), Estonia ranks fifth among EU countries that are also OECD members (see Figure 6.13). In addition, Estonia ranks very well with respect to full online availability, *i.e.* how many of the 20 basic services have reached stages four and five on the five-stage maturity model (see Figure 6.14).

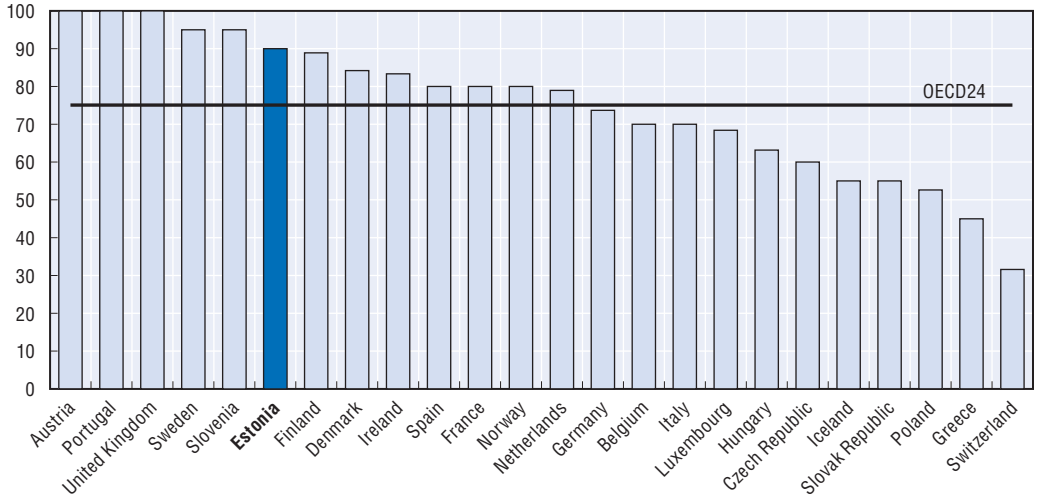
Figure 6.13. **Sophistication of 20 basic e-services, 2009**



The sophistication indicator assesses the maturity of 20 basic e-government services. Each of these 20 services is evaluated as to where the interaction between the service provider and user stands on the five-stage maturity model: 1) information is available online; 2) one-way interaction: forms can be downloaded online; 3) two-way interaction: forms can be completed online; 4) transaction: full electronic handling; 5) targetisation: personalised pro-active case handling.

Source: European Union (2009), *Smarter, Faster, Better e-Government, 8th Benchmark Measurement*, prepared by Capgemini for the European Commission.

Figure 6.14. **Full online availability, 2009**



Source: European Union (2009), *Smarter, Faster, Better e-Government, 8th Benchmark Measurement*, prepared by Capgemini for the European Commission.

There are examples of good practice, or "stars" in Estonia, such as e-taxes, the variety of services available through the e-ID – including the purchase of bus tickets (Kitsing, 2010) – and e-voting (an online service that may have a positive impact in terms of voter turnout, particularly at the municipal level). But there are also many areas that lag behind or are almost completely undeveloped (Kitsing, 2010). Among these latter categories are services related to drivers' licenses and unemployment benefits, as well as building and construction permits and municipal-based services. The overall availability, uptake, and effectiveness of e-government services, in fact, is dependent on the initiatives and capacities of individual ministries (Kitsing, 2010), as it is undertaken in a sectoral fashion. This is also true at the sub-national level, with local government initiatives often lagging behind those of the central level.

The inconsistency in service delivery quality and results appears to be due to insufficient co-operation across the Estonian public sector (*i.e.,* State ministries, and sub-national authorities) for the development of e-government services. While Estonia has excellent IT infrastructure, this needs to be more strongly linked with an overall approach and responsibility for service delivery which puts the citizen at the centre in order to promote horizontal and vertical co-operation for e-government services. Therefore, implementing a whole-of-government approach will contribute to overcoming the current problems in designing and developing high-quality e-government services in the public administration.

The fragmentation and disparities in e-government services may also be due to the absence of underlying co-ordination and collaboration mechanisms among ministries and agencies, compounded by the silo-ed nature of decision making across the public administration. Estonia's approach to e-government development is indeed decentralised, reflecting a structure and tradition of independent sectoral ministries and local authorities.

In the Estonian state administration, the Ministry of Economic Affairs and Communications holds political responsibility for the overall planning, development and co-ordination of e-government and for the development and implementation of State Information Society policy, while the preparation of the Information Society Programme for municipalities falls under the responsibility of the Ministry of Internal Affairs. The Ministry of Economic Affairs and Communication's *Department of State Information Systems* (RISO) is responsible for the co-ordination of State information systems, as well as for the development and implementation of State IT strategies. The Estonian Informatics Centre (RIA), which is a subdivision of the Ministry of Economic Affairs and Communications, is the supporting Agency for the development of common information systems in the Estonian Administration. It develops, co-ordinates, implements and operates the main components of Estonia's national e-Government infrastructure, including: the State portal, *www.eesti.ee*; the middleware system, X-Road; the Government backbone network, EEBone; the administration system of the State information system (RIHA); and the electronic document exchange centre (DEC); the development of individual information systems falls instead under the responsibility of IT managers in ministries, county governments, boards and inspectorates. Government Ministries and Agencies are also individually responsible for the implementation of the departmental e-government projects falling within their respective fields of competence.

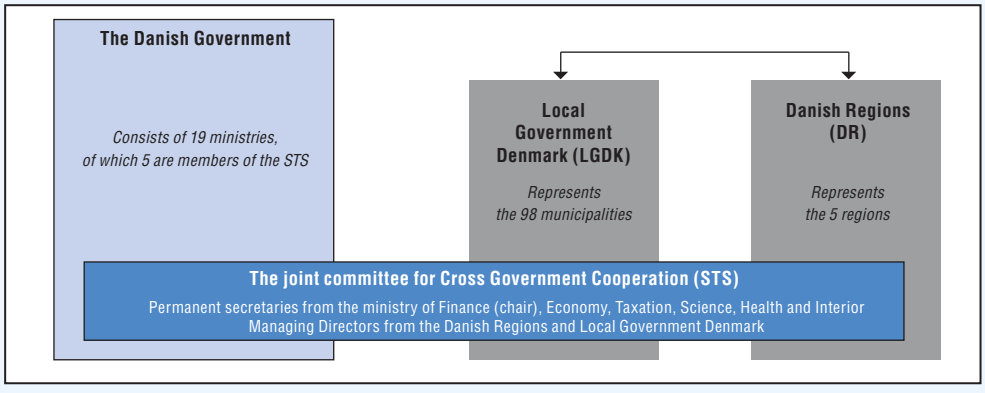
The Estonian Informatics Council is an advisory committee for the Government of Estonia. Made up of experts, it is the body in charge of implementing the general co-ordination of the State information policy, dealing with issues such as strategic planning, priority setting, ensuring financing, creating co-operation networks and ensuring their functionality, drafting IT legislation, and elaborating IT standards.

Although some co-ordination arrangements exist at the central level, co-operation among the ministries and the considerable number of other bodies playing specific functions in developing and implementing e-government appears to be a challenge. More formal, or institutionalised, co-ordination mechanisms and processes could foster more sustainable and effective co-ordination and collaboration in the long-run. The Ministry of Economic Affairs and Communications works well to maintain the infrastructure, undertake technical training, and develop the information society, and should continue to do so. However, this Ministry has neither the mandate nor the experience to push other ministries to do more, or to co-ordinate the efforts aimed at further developing e-government services. The same is also true for the Ministry of Interior/Regional and Local Affairs, which impacts its capacity to promote central level horizontal co-ordination to support the development of e-government services at the local level.

Increasing co-ordination within and across levels of government, or assigning the responsibility for the administrative development of e-government services under the same organisation holding a mandate for other areas of the public administration, could help address the inconsistencies in e-government services supply associated with sectoral-led development, and not generally evident when evaluating aggregate indicators. Increased co-ordination may be achieved through a number of different arrangements. OECD countries' experiences show that approaches to e-government co-ordination vary greatly, reflecting the political and administrative tradition, *e.g.*, the structures of government decision making, the extent of centralisation or decentralisation of responsibilities in government. Some countries have created strong national chief information officer positions or CIOs councils (*e.g.* Austria, Australia, the United Kingdom, the United States) while others have relied on the establishment of co-ordination bodies gathering all main stakeholders (*e.g.* Denmark, Switzerland, Mexico). The Danish experience, in particular, could be relevant for Estonia in terms of the small country size and the need for co-ordination efforts that involve both State and municipal governments (see Box 6.13).

Box 6.13. **Denmark: The joint e-government co-ordination structure**

Responsibilities for public service delivery within the Danish public sector are divided among the central government, municipalities and regions – each with its own elected political leadership and administrations. The Structural Reform that took effect 1 January 2007 strengthened significantly the role of municipalities, which took over a major part of the former counties' responsibilities, leaving the regions with responsibility mainly for hospitals and certain social institutions within the healthcare sector.



Box 6.13. **Denmark: The joint e-government co-ordination structure** *(cont.)*

In 2007, a Steering Committee for Cross Government Co-operation – STS (*Styregruppen for Tværoffentlige Samarbejder*) – was established as a result of a 2005 agreement between the Government, Danish Regions and Local Government in Denmark. The STS is a cross-government co-ordination body aiming at creating a common ground in the work on e-government. The overall framework for the co-ordination is confirmed in the annual negotiations on the next year's budgets between the Government and the representatives for the regions and municipalities.

The STS consists of high-level representatives (on the level of permanent secretaries/managing directors) from the five most important ministries for e-government implementation from the central government, and the associations representing the municipalities and the regions. STS has the following mandate:

- STS should put in place the overarching principles and coherent framework conditions that ensure that e-government solutions are developed across organisational boundaries, taking its starting point in citizens' and businesses' needs.
- STS should ensure progress and co-ordinate initiatives across the public sector in order to achieve a better use of resources through e-government – with citizens and businesses at the centre.
- STS should commence initiatives that broaden e-government implementation in the public sector.
- STS should join public sector initiatives in order to overcome barriers (legislative and regulatory, technical, organisational, etc.) for e-government implementation.
- STS should contribute to resolving specific conflicts of interest that have not been possible to resolve within e-government projects.
- STS should clarify model(s) for future operation and maintenance of e-government projects.
- STS should clarify solutions for coherency between efficiency and e-government solutions in order to ensure the right incentive structure.

Source: OECD (2010), *OECD E-Government Studies: Denmark: Efficient E-Government for Smarter Public Service Delivery*, OECD, Paris.

Increased e-government co-ordination is particularly needed at the sub-national level through the development of common solutions or frameworks (*e.g.* basic security infrastructure, connectivity systems, interoperability frameworks) which have not been adequately developed to support more integrated service delivery between the central and local levels of government and across local municipalities. Overall, ministries and local authorities need to learn how to develop a "business case" for developing and providing services collaboratively, which would help them to meet the pressures of fiscal consolidation while increasing synergies among services offered and fostering a stronger user focus. A good example is the electronic childcare system in the Ministry of Economic Affairs and Communication that was developed with the involvement of the Ministry of Interior/Regional and Local Affairs. Similarly, the Ministry of Interior/Regional and Local Affairs is undertaking a series of e-government services projects (see Box 6.14), which can address the issue of building e-government service availability at the local level, but simultaneously reflects the sectoral nature of online service development. When fully implemented, these initiatives could be a basis for stronger e-government service delivery at the municipal level. However, success will depend on take-up by municipalities, and their capacity to fully utilise the technologies and services. There appears to be demand for

Box 6.14. **E-Government services initiatives sponsored by the Ministry of Interior/Regional and Local Affairs**

Estonia's Ministry of Interior/Regional and Local Affairs is expanding its activity in the area of e-services for municipalities through a series of IT initiatives to help build capacity in areas corresponding primarily to administration and management. These include VOLIS (already being implemented) and several others currently under development.

- VOLIS – "Information system of the local government Councils": A software package that develops e-government, participatory democracy and document management. It aims to help raise the quality and efficiency of activity in local government administrations; provide a more efficient document management system; improve the speed and quality of e-services; raise participatory democracy by enabling citizens to read the documents related to the work of local government, as well as presenting their own proposals, comments and opinions regarding draft legislation and other subject matters; promote transparency and civic understanding by permitting citizens to see the meetings of local councils, which can have a positive impact on the relationship between citizens and representatives of government.
- KOVISKE – "Improvement of local government security measures": this project intends to raise the awareness and knowledge of local governments on data security.
- KOVMEN – "Process management environment of the public services of local governments": this initiative intends to improve data flow between public authorities and citizens by avoiding unreasonable requirements for paper documentation of data can be obtained through national or local government databases.
- KOVTP – "Universal service portal of local governments": a programme intended to standardise the websites of local authorities and to improve the accessibility of information and e-services provided at the local level.
- KOVPA – "Document management system of local governments": intended as a means to synchronise document management in local authorities.

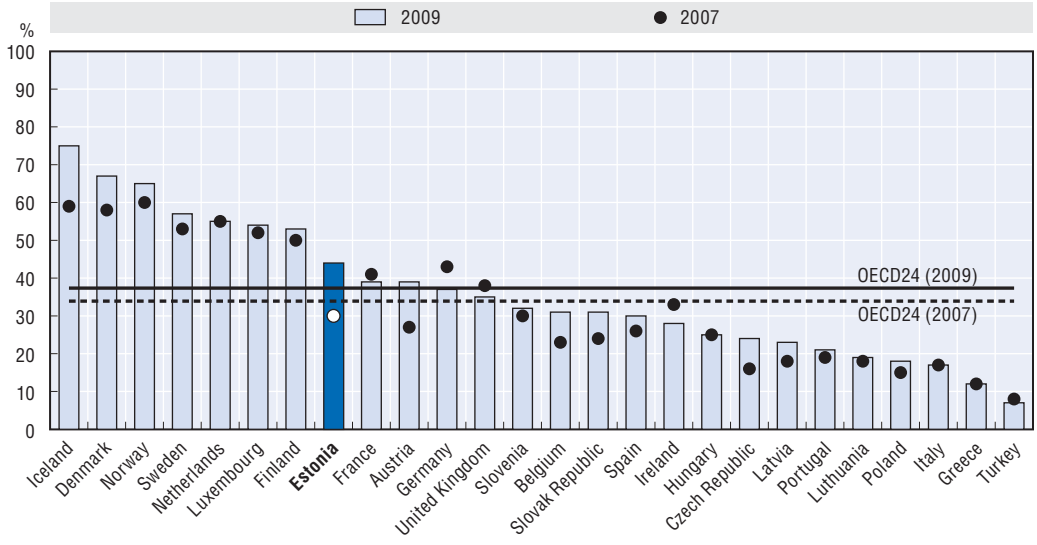
Source: Data provided by Ministry of Interior/Regional and Local Affairs, Government of Estonia (2010).

training by local governments, as opportunities offered by the Ministry of Economic Affairs and Communications have been well attended.

Improving the offering, quality and user-focus of e-government services requires not only a driver to push information and experience sharing, to create frameworks and incentives for collaboration, and to set whole-of-government strategic directions for the development of e-government; it also implies higher harmonisation of IT systems, and building central, as well as sub-national, capacity. The latter could take the form of identifying and sharing good practices already integrated into the activities of other ministries; working more closely with the private sector to identify needs and build systems to meet them; continuing to improve and facilitate access to necessary technology (such as e-ID card readers). Initiatives in this area, together with more efforts targeted at increasing public awareness of available online services through marketing and advertising campaigns, can help Estonia boost user take-up, and continue building on the significant progress it made in this domain between 2007 and 2009, when compared to the 23 OECD-EU member countries and also Latvia and Lithuania (see Figure 6.15).

The key is to understand that e-government services need to be viewed as part of a multi-channel service delivery strategy, and as a strategic driver for improved and

Figure 6.15. **E-Government user take-up in OECD-EU member countries and Baltic States, 2007 and 2009**



Source: Eurostat Databases (2010).

joined-up services organised around citizen needs. While it has improved in recent years, the up-take of e-government services is lower than desired (see Figure 6.15). To reach citizens, online services need to not only be available, but to be organised around citizens' needs and expectations, building on the citizens' right to quality services as stated in its e-State Charter, which provides a series of principles and standards for high-quality electronic communication between government and citizens.

Estonia could consider adopting a whole-of-government strategic approach to e-government services development and delivery, using the e-State Charter as a starting point. Such an approach would embed a common perspective and help set national directions for service development. It would also permit Estonia to better capitalise on its existing shared infrastructure and back-office components *(e.g.,* interoperability framework, communication networks, common systems and databases, middleware solutions, shared services) which provide a common platform for the provision of online services to citizens and businesses. This single government approach *(e.g.,* a common agenda in the form of a vision set out in a policy document, supported by a national e-government and service delivery strategy) could be associated to an action plan, which could identify a roadmap with the prioritisation of the development of certain joined-up and integrated e-government services requiring a wide spectrum of actors to work together in new and innovative ways and to share data, resources, and systems.

Developing a coherent approach to public service delivery

The capacity of the Estonian public administration at the central and sub-national levels to realise its service delivery objectives is currently undermined by a lack of resources and of co-ordination. This is due, in part, to insufficient linkages between the ministries as policy-making authorities, and the sub-national bodies that have implementation responsibility for many of these policies.

The gap between the desire for good services and the ability to deliver them can be reduced by removing barriers for different parts of the public administration to work together. Fragmentation of standards and approaches, and the lack of basic templates for common processes, decision making, and co-operation agreements all contribute to these barriers, as do sector and level-of-government differences in terms of training and working methods. A stronger, more coherent enabling environment is needed to provide a common platform for collaboration across state and sub-national governments and among municipalities, and to reduce the need to re-invent new processes. This requires a strong and more consistent approach to administrative services, for example developing common quality standards and measurement methodologies, service level agreements, ICT services, and training.

Currently, each sector ministry has its own responsibility for administrative services, and the vertical and silo-ed institutional structure among central level bodies further fragments these. In addition, the weak co-ordination mechanisms in the Estonian public administration, both horizontally and vertically, hinder the ability of national and sub-national governments to work together to deliver citizen-centred services. This is evidenced, for example, by policy and service-structure incoherence at the sub-national level, and by the slowness with which common tools and platforms are being developed and adopted. Improved co-ordination of administrative services, including project and programme management, would allow for better targeting of scarce resources, reduce redundancy, and enable cost-sharing in the development of administration tools (see Box 6.15).

Box 6.15. **Building joined-up administrative services in fragmented environments**

Estonia's Tax and Customs Board has been taking pro-active steps to provide tax payers with better service by improving internal operations. For example, it is working with the Consumer Protection Board to develop a common front desk arrangement, focusing on generic, rather than agency-specific, functions. The idea is to provide a network of front desk servicing *(e.g.,* call centres), supported by back office processing at the agency level. The Board considers that, as citizens do not necessarily understand government structures, a one-stop-shop type of arrangement may be easiest for them to navigate. It is now looking for other agencies *(e.g.,* agricultural subsidies board, police and immigration) to join it in implementing this concept. In 2010, this idea was still a proposal, as there were some legislative matters that needed to be worked through, including data protection. In addition, for such a proposal to work smoothly it would require very good co-ordination among agencies.

"Bottom-up" approaches such as these may result in higher levels of co-operation among the organisations using or ensuring such solutions (OECD, 2005b). As a major public provider of services, the Tax and Customs Board has demonstrated a willingness to take the leadership in developing common services, leveraging its capacity to provide and promote aggregate points of shared administrative services. However, the greater the fragmentation of a system – *i.e.,* more small players – the greater the need for shared administrative services so that these smaller entities can reap the benefits associated with aggregation or virtual service delivery. While a centrally directed initiative may not always be desirable or possible, common standards, tools, frameworks, and guidelines can provide a platform for collaboration among many partners and help to overcome technical barriers to co-operation.

Source: OECD interviews; OECD (2005), *E-Government for Better Government*, OECD, Paris.

Some central co-ordination of administrative services does take place at the state level, notably by the Ministries of Finance *(e.g.,* budget and human resource management), Justice *(e.g.,* regulatory policy management), Economy and Communication *(e.g.,* ICT infrastructure), and Interior/Regional and Local Affairs for the sub-national level. However, these efforts fall short in two ways. At the state level, the mandate to co-ordinate administrative services is carried out in a technical and narrow fashion. This does not permit sufficient linkages between individual work on sets of administrative services and the promotion of overall efficiency and effectiveness in public service delivery. At the sub-national level, while the focus is broader, there is insufficient capacity to fulfil the mandate, limiting the effectiveness of actions in this area.

To overcome these co-ordination weaknesses, stronger leadership is needed in order to bring a strategic and results-oriented perspective to administrative service activities, to identify linkages and synergies across the different administrative service areas *(e.g.,* training for ICT or regulatory impact analysis), and to ensure capacity to deliver real benefits (see Box 6.16).

Box 6.16. **Common business processes and referential models**

"Common business processes" (CBP) are one of several strategies OECD countries employ to organise public functions and services around user needs rather than around government structures. Once identified, CBPs can be co-ordinated in various ways by the organisations using the CBP. One of these is a "referential model" (a commonly agreed standardised process which provides guidelines, standards, etc.). The concerned organisations will execute the processes themselves according to the model.

In Germany, the Competence Centre for Workflow Management Processes and Organisation, a competence centre specialised in business processes, draws up referential models for business processes that are common to many organisations. The organisations can use these models to organise their own business processes. Because of its ease of use, this kind of solution is much more likely to be adopted by organisations.

Source: OECD (2005b), *E-Government for Better Government*, OECD, Paris.

OECD countries address the challenge of developing and managing administrative services in different fashions. Finland has tackled this issue by consolidating the responsibility for administrative services, including municipal management, in the Ministry of Finance. Within the Finnish Ministry of Finance, the departments of personnel, municipal affairs (including municipal finance), and public management together make up the Ministry's "Governance Policy Pillar", comprised predominantly of policy staff. The directors of these groups meet regularly in order to ensure better steering, co-ordination and synergies for meeting the needs of the public administration as a whole. Municipal affairs was added in 2008 in order to enable a more consistent approach to administrative development across the state and sub-national administrations and to bring activities that support the effectiveness and efficiency of sub-national authorities closer to where municipal funding decisions are made. Finnish public officials view this change in a positive light. They indicate that it has re-enforced a shared culture, as well as a better understanding and more "holistic" perspective on service delivery, shifting it away from one driven by the point of view of a specific government level or interest.

The Danish Ministry of Finance's Local Government Economics Unit defines its primary responsibility as the overall management of the local governments' economies. As in Estonia, this is heavily focused on the co-ordination of the sub-national budget process and negotiation with local authorities. Additionally, however, the Danes also take a full management approach, which includes initiatives and projects that support local-level capacity for quality development, efficiency, reduced bureaucracy, public administration and management policies, budget systems, and quality of regulation (Denmark, Ministry of Finance, 2010). The Danish Ministry of Finance also houses the Centre for Administrative Efficiency and e-Government, which develops and implements e-government and other efficiency-related initiatives to support public sector modernisation. The Centre focuses on state level activities, including projects where vertical co-ordination among the central, regional and local levels is necessary. The case of ICT policy development in Denmark, particularly at the local level, is a good example of integrated vertical co-ordination: the policy or strategy is set by municipalities; co-ordination is ensured by the Steering Committee for Joint Government Co-operation[13]; implementation rests with the local authorities; and support comes from various sources including the National IT and Telecom Agency, the National Association of Local Authorities (LGDM), and a company owned by Danish local and regional authorities (European Union, 2010).

In Ireland, the Department of Environment, Heritage and Local Government established the Local Government Management Services Board (LGMSB) in order to provide local authorities with a series of administrative and management services. Presently, the LGMSB is divided into four divisions: a human resource division that, among other things, investigates and develops human resource strategies and policies to support local authorities in their ability to address training and development needs of local public administration staff in meeting service delivery requirements; an industrial relations division that participates in preparing and negotiating with trade unions and staff associations; the Office for Local Authority Management, which identifies trends that could impact local government and that also may require a co-ordinated response, as well as providing responses that use national and international good practise, and working with other government bodies and appropriate associations; a corporate services division that services the LGMSB itself (LGMSB, 2010). This Board is also supported by the Local Government Computer Services Board (LGCSB), established to provide shared ICT services to local governments. It works with local authorities in the development and implementation of ICT strategies and systems, and when appropriate, can also assist in organising national contracts for hardware and software (LGCSB, 2010). Also part of the Department of the Environment, Heritage and Local Government is the Local Government Administration, which has oversight responsibilities for the functioning of the local government system, as well as responsibility for implementing policy corresponding to local government structure, functions, human resources and financing.

In the Netherlands, the Ministry of Interior and Kingdom Relations, together with the Association of the Netherlands Municipalities, established the ICTU, a foundation that acts on behalf of government authorities – be they central, regional, local, or water boards. Its primary area of operation is e-government, and it is commissioned by authorities to work on generic IT matters. To do so effectively, however, it must also be involved in policy development and implementation. As such, it is a centre of expertise for drafting tenders, developing business cases, contract and project management, and other types of administrative expertise for government bodies to draw upon (ICTU, 2010).

In these cases, responsibility for service delivery remains in the hands of sectoral ministries and municipalities, while administrative services are centrally co-ordinated. This permits the pooling of resources and expertise, while providing common frameworks and tools for horizontal and vertical co-operation. Other countries place the responsibility for central-level public service delivery in the hands of a single agency. This is the case in Canada, where Service Canada is responsible for providing a full range of citizen services, organised by life event and by subject, including education and training, employment, housing, personal documents and starting a business. Still other countries give responsibility for delivering related categories of central services to a single Ministry. This is seen in Australia, where the Department for Human Services has responsibility for social and health-related services including child support, social services and payments *(e.g.,* for pensioners, families, people with disabilities), and health services and payments *(e.g.,* pharmaceutical benefits, and the child immunisation register).

The examples above outline two general approaches for ensuring responsibility for public service delivery. Either the responsibility lies with the sectorally relevant body – a ministry or agency, for example – or an organisation is established that is fully responsible for central-level public service delivery. Regardless of the model pursued, it is critical that: *a)* responsibility is clearly established and communicated; *b)* lines of accountability are well drawn and communicated; *c)* "customers" know who to go to for the service, and whom to praise or to whom complain when there is a problem.

It is important to note that, of the examples cited, only the Finnish Ministry of Finance combines responsibility for municipal policy with administrative services impacting the local level. In the other cases, co-ordination and provision of administrative services at the local level is separated from responsibility for municipal policy, which is located elsewhere. The focus, instead, is on public sector efficiency and effectively serving citizens, businesses and government.

Estonia could reinforce its enabling environment for improved service delivery by further consolidating administrative service responsibilities, which are currently spread across the Ministries of Economy and Communication, Finance, Interior/Regional and Local Affairs, Justice, line ministries, the national municipal associations, and county municipal unions. In the short term, this would mean more co-ordination to align platforms and standards, which could pave the way for centralising procurement and greater co-location of administrative services. In addition, it means building and supporting co-ordination capacity at the central and sub-national levels, including through stronger incentives and accountability for horizontal working, training for greater professionalisation, supporting communities of practice, and quality management. In the longer term, Estonia may wish to consider an approach where central and sub-national administrative service activities are consolidated into one ministry, or establish a separate entity that is entirely responsible for ensuring the delivery of public services, both those that are responsibilities of the central level as well as the sub-national level.

Involving citizens, non-government actors and public servants in public service design and delivery

If services are to be reflective of citizen needs, the involvement of citizens and other non-government actors in service design and delivery becomes essential. The traditional paradigm for service delivery sees government as direct producer of public services with policy and delivery responsibility being held together (*i.e.,* a government-led delivery

chain). Partnerships with external actors such as private sector providers (*e.g.* outsourcing, concessions, contracting-out, etc.) have brought greater flexibility and efficiency to service delivery, but care needs to be taken that this also translates into better-quality services and/or higher user satisfaction, which is not always the case. Public-private partnerships (PPPs) are not frequently used in Estonia (see Box 6.17). Adjustments in the accounting methodology for PPPs could open the road to greater alternatives in terms of service providers. Any move in this direction, however, should be coupled with mechanisms to build municipal capacity in contract negotiation.

Box 6.17. **Public Private Partnerships at the local level in Estonia**

While public-private partnerships (PPPs) can be and are used to varying degrees by OECD member countries to meet public service delivery challenges, they can also help sub-national levels overcome capacity challenges that impact service delivery. In Estonia, however, the use of PPPs by the sub-national government is somewhat limited. Municipalities have tried to take this route, but have encountered an accounting obstacle. For example, PPPs were used for the re-construction of schools. The school was given to a private company to rebuild and maintain, and the municipalities would pay rent to the company for the use of the infrastructure. This rent would be accounted for in the budget as a lump-sum investment. The investment decreases over the years as the rent is paid out. However, because such investments are classified as loans in the budget, the municipalities cannot necessarily take out loans for other projects. This causes problems for the municipalities in terms of budget, budget balancing and future financing via loans.

Source: OECD (2008), internal documents, unpublished.

New forms of partnerships between government and non-government actors are emerging and have a potential to create better outcomes in terms of user satisfaction and decreased production cost. These are user-centred collaborative approaches where citizens, users and non-government organisations (NGOs) directly contribute their own resources *(e.g.,* time, knowledge and efforts) to the design and delivery of public services. One example is a group of residents partnering on a volunteer basis with local police to increase safety in their neighbourhood. These approaches are also referred to as "co-production". The result of a survey on co-production in service delivery among OECD countries indicates that, while co-production is not a new concept in Estonia, it is not yet widespread (examples can be found in areas such as social protection, public order and safety and environmental protection) though mixed forms of service delivery exist.

In Estonia, non-traditional forms of co-operation on service delivery tend to combine elements of contracting out and direct co-operation with NGOs[14] to reduce local public service costs and help better reach specific target groups. There are examples of NGOs' input in service delivery both as a substitute for and in addition to professional services. This is particularly true in the case of smaller local governments with limited funding flexibility. Experience has shown that NGO involvement has the potential to bring higher-quality services compared to professional services thanks to NGO service ethics, as well as flexibility and capacity to target unmet needs (see Box 6.18).

To be effectively implemented, collaborative forms of service delivery require a combination of factors including top-level commitment, enabling frameworks *(e.g.,* legal,

Box 6.18. **The involvement of NGOs in public service delivery in Estonia**

ZZ Youth, a civil society organisation (CSO) created by active local citizens in Kambja, has been entrusted by the local government to plan and manage the services of the Open Youth Centre. This experience shows how partnerships with non-government actors can help respond to a community's need which could not have been met by local government acting alone due to limited resources.

Indirectly, the purpose of this co-operation is to reduce local government budget expenditures through the outsourcing of the necessary knowledge and skills. The local government and ZZ Youth operate on the basis of a five-year contract in which the local government provided the physical infrastructure for the centre without a fee and covered the operational costs (including staff salaries). The CSO was given the responsibility to decide on and manage the Centre's services, thus substituting professional services. The user community plays an important role, as user groups are involved by ZZ Youth to participate in annual evaluation meetings to assess the quality of the service delivered and suggest improvements in the service.

Source: OECD (2010), *OECD Questionnaire on Innovation in Public Service Delivery*, Responses from the Government of the Republic of Estonia and Praxis 2010.

budgetary, etc.) and the necessary knowledge and skills on the part of the public sector, professionals and citizens to co-produce. The results of the OECD survey for Estonia indicate a lack of knowledge and skills to co-produce, and the absence of financial incentives for service improvement as the greatest barriers to co-production. Low general capacity and professionalisation of Civil Society Organisations (CSOs), which inhibits further development of such collaborative approaches in Estonia, are also indicated.

Listening to citizens

In order to better understand citizen needs with respect to service design and delivery, governments are identifying new or innovative ways to develop and structure services. While service delivery can be approached structurally, individual delivery needs should not be forgotten and thus attention also should be paid to the citizen's experience. Finland's Kuopio municipality provides an example in this area; it has shifted the structure of public services from a sectoral basis to one following the citizen life cycle (see Box 6.19).

Box 6.19. **Finland: Kuopio municipality's life-phases service delivery framework**

In 2005, Kuopio municipality began to explore alternatives to meeting the pressures familiar to other Finnish municipalities: a wide range of service competences to fulfil; an ageing population with an accompanying increased demand for targeted social services; financial and human resource constraints; and the need to meet central-level objectives for productivity and administrative structure. It began to re-think service classification, which resulted in an innovative approach to service structure renewal.

With a goal of providing better-quality services from the citizen perspective, and in a more efficient manner, in 2007 the Kuopio City Council adopted a life-phases framework for local service delivery (see Table below). In 2009, the timetable for the rollout was incorporated into the city budget. By organising services along life phases, the spotlight shifts from government and what it provides to citizens for their consumption, to citizens and how their service-oriented needs can be met by government.

Box 6.19. **Finland: Kuopio municipality's life-phases service delivery framework** *(cont.)*

Kuopio municipality's life-phases framework

Life-phase	Targeted citizen-user group
Supporting growth and learning	Children, youth (including guardians and children)
Supporting daily life	Those who need support in their daily life (*e.g.,* families, those needing financial support)
Strengthening business life and attractiveness	Business owners and organisation leaders, current or future residents of Kuopio, travellers
Supporting welfare	People looking for recreation, people with hobbies, etc.
Maintaining health	People falling into a risk group, with symptoms of illness, or who have fallen ill
Developing and maintaining the living and operational environment	Those needing a place of residence, permit application, users of the urban environment

It is too early to measure the impact of this initiative. However, the Kuopio life-phases service delivery framework is supported by factors critical to success, including political will on the part of the City Council, and a structured allocation of resources through the city budget. It provides a strong local-level example of:

- Clear citizen orientation and the role of service provision in societal outcomes.
- Clear and straightforward steering of functions.
- Leadership and a focus on addressing the issues at hand.
- Organisational agility.

In addition, it is reported to have enhanced the capacity for change; created more efficient task entities; and promoted a more independent and responsible working culture.

Source: OECD (2010), *OECD Public Governance Reviews: Finland: Working Together to Sustain Success*, OECD, Paris.

Placing attention on the citizen also can link directly to building the capacity of the public administration at all levels of government and to providing a channel for adjusting the attitude of public servants, thereby contributing to shifts in organisational culture. In Australia, for example, "Value Creation Workshops" are undertaken with citizens so that public servants and policy designers can hear their stories. This interaction helps shape service design and offerings. As a next step, Australia is moving towards co-design and ensuring that citizens help to design services. Finland has also gone "straight to the citizen" in Kainuu when seeking to improve healthcare service delivery at the local level (see Box 6.20).

In general, successful public service delivery is thought of in terms of effectiveness – encompassing efficiency, equality of provision, access, and quality. It has been recognised, however, that public service performance cannot be evaluated only in terms of the efficient and effective use of resources, but also must consider the capacity of public services to generate public value for key stakeholders (*i.e.,* citizens, businesses, clients, public sector employers and employees, and society as a whole). Thus, in seeking to improve service delivery it may be more appropriate to place greater weight on citizen satisfaction with the mix of services provided as a "success measure", and then consider other elements of effectiveness, including efficiency. This would go hand-in-hand with current innovative models of service delivery which focus on the role of service users in designing, delivering and evaluating public services (OECD, 2010i).

Box 6.20. **Finland: Incorporating a citizen perspective in Kainuu healthcare service provision**

In keeping with the principle of a client perspective, the Kainuu Regional Council, through the Joint Authority of the Kainuu Region (responsible for healthcare provision), developed the "Happenings" programme to better identify and respond to the needs of healthcare users. Under this programme, the healthcare team visited all municipal health clinics twice. During the first meeting – open to all citizens who wished to participate – the team presented the different services available at/or through the clinic, followed by a question-and-answer period with the regional healthcare team, the clinic service providers, and the municipal residents. After approximately 10 days, the team returned to the municipal clinic for an evening session, where they shared the input and feedback they had heard during the previous visit. They then worked together with citizens to identify solutions to some of the most pressing concerns. The team noticed that sometimes the small things mattered most. For example, the healthcare providers at both the regional and municipal levels believed that everyone knew the telephone number for a 24/7 nurse call-centre. This, however, was not the case – and a quick, easy and low-cost solution was found to ensure that all citizens were aware of and had easy access to the appropriate number.

Through "Happenings", the Kainuu healthcare team built awareness among citizens of the variety of services available to them. In addition, rather than depending strictly on feedback from clinic practitioners, the team listened directly to the end users of the services. This allowed the development of more targeted and community-tailored solutions, increasing the effectiveness of the services provided, as well as their efficiency. Because reform to healthcare systems at any level is a highly sensitive issue, by developing a two-way communication channel and acting on citizen input, the Council increased the potential for residents to feel that they had a role in the process. This, in turn, could increase trust in the reform process and a sense of "ownership" of the services available in their community.

Source: OECD (2010), *OECD Public Governance Reviews: Finland: Working Together to Sustain Success*, OECD, Paris.

Listening to those public servants who deliver services is equally important. Also in Australia, situations have been created where service delivery staff is brought into the policy units, given a policy problem and asked to solve it. This can also help feed policy design. In addition, Australia provides its policy designers with the opportunity to participate in "outbound programmes" where they go into the field, spending time behind the service counter, working with the homeless, etc. Senior-level Department Secretaries also spend some time in local communities to better understand the citizens and their needs. The result is a stronger and directly enriched continuum so that policy development and service delivery enjoy greater alignment, rather than being at odds with one another.

Improving relationships across levels of government to enhance service delivery and policy outcomes

Service delivery capacity and outcomes depend greatly on the context of multi-level governance relations (*i.e.,* the relationship between levels of government). This relationship is characterised by the mutual dependence between levels of government that arises in decentralised contexts. No single level of government can act alone. Rather, each level relies on others to fulfil their obligations to citizens and government mandates, regardless of constitutional type (federal or unitary state) or degree of decentralisation (Charbit and Michalun, 2009).

The challenges facing the multi-level governance relationship in Estonia mirror those seen centrally: weak co-ordination and inefficient co-ordination mechanisms. This is common in decentralised contexts, and the OECD has developed a diagnostic tool to help identify co-ordination gaps (see Box 6.21). The gaps confronting multi-level governance stem from asymmetries that arise as a result of one level depending on the other – either for skills, resources, or competences – and can exist vertically and horizontally. The multi-level governance relationship impacts local authorities, service delivery by all levels of government, and regional development.

Box 6.21. **"Mind the Gaps": A diagnostic tool in multi-level governance relations**

Governments face a series of "gaps" (in terms of specific deficiencies) in multi-level governance relations. The OECD has identified a set of seven gaps that are shared to greater or lesser degrees across countries.

- An *administrative gap* arises from a "mismatch" between functional areas and administrative boundaries. This would require instruments for reaching a "effective size".
- An *information gap* is characterised by information asymmetries (quantity, quality, type) between stakeholders, generally levels of government, when designing, implementing and delivering public policy. Overcoming this requires instruments for revealing and sharing information.
- A *policy gap* results from sectoral fragmentation across ministries and agencies, occurring most frequently when ministries take purely vertical approaches to cross-sectoral policy *(e.g.,* energy policy, water policy, youth policy, etc.). Managing this requires mechanisms to create multi-dimensional/systemic approaches and to exercise political leadership and commitment.
- A *capacity gap* is created when there is insufficient scientific, technical, infrastructural capacity among local actors. To overcome this gap, there is a need for instruments that build capacity.
- A *funding gap* arises when revenues are unstable or insufficient, thereby undermining effective implementation of responsibilities at the sub-national level or for cross-sectoral policies with sub-national impact. It is represented by the difference between sub-national revenues and the required expenditures for sub-national authorities to meet their responsibilities, and indicates a direct dependence on higher levels of government for funding and for a fiscal capacity to meet obligations. In the case of a funding gap, there is a need for shared financing mechanisms.
- A *objective gap* occurs when different rationales create obstacles for adopting convergent targets and can be created due to lack of horizontal co-ordination at the central level for matters affecting the sub-national authorities. Thus, what is called for are instruments which can help align objectives.
- An *accountability gap* emerges when there is difficulty to ensure the transparency of practices across different constituencies. Institutional quality instruments would be applicable to address this gap.

Source: OECD (2011), forthcoming, *Governance of Public Policies in Decentralised Contexts: The Multi-Level Approach*, OECD, Paris.

The multi-level governance structure in Estonia

The multi-level governance dynamic in Estonia is characterised by fragmentation arising in part from a large number of different actors and a lack of co-ordination, co-operation and collaboration among these at various levels and to various degrees. At the sub-national level, Estonia's 226 municipalities are led by democratically elected Municipal Councils who then select a head of Council and elect the municipal mayor who serves as the municipal manager. The country is divided into 15 counties, which represent the central government at the regional and local levels. Counties are led by County Governors who are appointed by the Government for a five-year term. The candidate is proposed by the Minister of Regional and Local Affairs to the Government. Municipalities have input into the process through the general meeting of the national municipal associations which provide their opinion on the candidate. The Governors report to the Minister of Regional and Local Affairs. Legally, counties are increasingly weak entities, as competences get further devolved to municipalities or re-centralised into ministries and agencies. In addition, decisions affecting the local area rest with municipalities, and county-level development planning (a county responsibility) can be blocked by municipalities through non-participation or by the central government given the lack of a dedicated State budget line for county development plans. Relations among municipalities in a county, including co-operation for service delivery, are either co-ordinated individually (one-on-one) or via County Municipal Unions, non-profit voluntary entities which are funded through membership fees paid by local authorities.

At the national level, two associations of municipalities (the Association of Estonian Cities and the Association of Municipalities of Estonia) represent municipal interests before the central government. At the central level, the Ministry of Interior's Department for Regional and Local Affairs is responsible for policy planning and developing the local government system in Estonia. The Ministry of Finance's Local Government Unit, is responsible for local government finance and budget matters. Line ministries *(e.g.,* Education and Research, Social Affairs, Environment, Agriculture, Economy and Communication, etc.) develop their own policies and programmes, including services (and e-government services), for implementation at the local level, either through their county regional offices or directly by municipalities. Finally, the county Governors, the Legal Chancellor and the National Audit Office are charged with the external supervision and audit of municipalities. Without strong co-ordination and oversight, a structure such as this can result in high levels of incoherence in policy planning and implementation, as well as in service delivery. Co-ordination challenges can be addressed from a structural or a management perspective, with a well-developed array of vertical co-ordination tools and capacity at all levels of government.

The Ministry of Interior's Department for Regional and Local Affairs, led by the Minister for Regional Affairs, is tasked with co-ordinating the multi-level governance relationship. It is responsible for regional planning, including measures corresponding to municipalities and NGOs. It also develops the programmes and priorities associated with EU Structural Funds in regional development, and it undertakes the co-ordination and monitoring these. (Implementation of such programmes, however, is the responsibility of Enterprise Estonia.) In addition, large-scale sub-national reform originates with the Ministry of Interior/Regional and Local Affairs, as do initiatives underway to directly serve or benefit local authorities, such as e-government services, and a cataloguing of services provided by municipalities. It is also responsible for co-ordinating sectoral initiatives that impact the local level in order to ensure policy coherence. It has no jurisdiction over the policies of sectoral ministries and it faces low capacity to co-ordinate horizontally on matters with sub-national implications and

to successfully introduce broad-based policy initiatives. Evidence of fruitful cross- sectoral co-ordination for sub-national initiatives exists, though it can bypass the Ministry of Interior/Regional and Local Affairs. For example, the Ministry of Education and Research, in collaboration with the Ministry of Social Affairs, launched an integrated policy initiative for youth affairs in 2008.

Building collaboration among sector ministries in central/sub-national matters

In Estonia, sub-national authorities are under the jurisdiction of the Ministry of Interior/Regional and Local Affairs, while sector policy guidance and regulation depend on the competent sector ministry. This can lead to gaps in policy, oversight, and information among central-level bodies and between the central and local levels. These gaps can be exacerbated depending on the source of funding for services. For example, in the area of social care for the elderly, the Ministry of Social Affairs and Health has policy competency, but services are primarily funded by municipalities. As a result, the Ministry is hesitant to establish service standards in this area, and the county-level authorities only inspect social care facilities in cases of complaint. In the end, no public body has complete responsibility for ensuring that the elderly have access to and receive quality social care (see Chapter 8: "Case Study Two: Social Services for the Elderly in Estonia").

Since 1999, there has been a trend among Estonian ministries to strike out on their own when organising their sub-national or regional offices, including those of their agencies. For example, in 1999 the then-Minister of Environment transferred to the ministry the responsibilities of the environmental departments of each county, creating 15 county departments of the Ministry of Environment. In 2009, these county departments were re-formed and a new agency, the Environmental Board, was established. In 2010, the Environmental Board operated out of six regions (with 15 county units), and one central office. This trend is seen not only in the Ministry of Environment, but in other ministries as well (see Table 6.8).

Table 6.8. **Examples of ministerial organisation of regional authorities**

Ministry	Agency	Number of Regional Authorities or Departments	Number of County Units	Central Office
Environment	Environmental Board	6	15	Yes
	Environmental Inspectorate	4	11	Yes
	Land Board	0	15	Yes
Interior	Police and Border Guard Board	4	15	Yes
	Rescue Board	4	15	Yes
Justice	Courts	4		
Agriculture	Agricultural Board	14		Yes
	Registries and Information Board	7		Yes
	Veterinary and Food Board		15[1]	Yes

1. The 15 county sub-agencies operate independently from the central office and function as their own separate organisations with executive powers.

Source: OECD interviews.

Such arrangements can generate incoherence, increase fragmentation, reinforce silos, and can hinder a single government approach among and within government entities. Managing a system of this nature requires high degrees of co-ordination capacity and

communication to ensure that information is exchanged properly and in a timely fashion. In a country like Estonia, where co-ordination and communication across government bodies is a challenge, this situation becomes particularly risky with respect to effectiveness and efficiency from a whole-of-government and public service delivery perspective. While the reasons why such a situation can arise are numerous, including few central government guidelines or no explicit policy with respect to territorial activity, it is more important to look at what can be done to address the issue. In moving towards a single government approach, it would be necessary at this level to build coherence in the system and facilitate co-ordination among central-level bodies at a sub-national level. This is particularly true since many of these entities have a direct impact on citizens (*e.g.*, Rescue Board, Police, Land Board, etc.), their activities and businesses, and the services they receive. Addressing the situation can mean streamlining or consolidating structures (*i.e.*, rationalising) and re-evaluating the number of territorial administrative units in a country the size of Estonia, *i.e.*, with an eye on reducing the number of counties.

Improved alignment of all of the relevant actors affecting a policy area would help to clarify regulations and identify cross-sector interactions (*e.g.*, between health and social services). This could also help focus central and sub-national actors on agreed-upon policy objectives, thereby clarifying their own responsibilities. Finland took this approach with the ALKU regional reform, which addressed both co-ordination and streamlining in central/sub-national relations (see Box 6.11). In a single government approach it is important to identify the responsibilities of each party in a policy initiative, with individual responsibility for inputs and outputs by relevant sectoral actors (*e.g.*, line ministries, counties, local authorities), and shared responsibility for outcomes.

While Finland's approach to aligning responsibilities and enhancing co-ordination across levels of government through its ALKU reform was primarily administrative (albeit with political steering), in Sweden the discussion began in the Parliament through the Committee on Public Sector Responsibilities. This body was tasked to identify what changes would be needed in the public administration system and governance arrangements to meet future service delivery challenges (see Box 6.22).

Box 6.22. **Sweden's Committee on Public Sector Responsibilities (2003-07)**

The Parliamentary Committee on Public Sector Responsibilities (*Ansvarskommittén*) was created in January 2003 to examine the structure and division of responsibilities in the public administration, and to determine whether changes are needed in the division of responsibilities and in governance arrangements in order to meet the challenges public sector services will face in the future. The Committee was composed of members of Parliament and other representatives of parliamentary political parties. In addition, high-level experts from national government offices and from the Board of the Swedish Association of Local Authorities and Regions (SALAR) participated in the work of the Committee. One of the Committee's main aims has been to examine the relation between the national government and government agencies, and the division of responsibilities among the national government, the county councils and the municipalities.

The conclusions of the Committee on Public Sector Responsibilities have gained broad support among public officials in Sweden. The process is an example of consensus-building, as it was carried out through a comprehensive and in-depth analysis, with the support of different sectors of Swedish society, including SALAR and the main regional and local actors.

Box 6.22. **Sweden's Committee on Public Sector Responsibilities (2003-07)** *(cont.)*

In all, there were five years of in-depth consultation and discussions throughout the country involving thousands of people. Broad agreement was achieved on the analysis and the way forward. The Committee's report has been circulated for comment, and opinions have been received from 543 consultation bodies (government agencies, county councils, municipalities, SALAR, regional co-operation councils, etc.). The overall response from the consultation was very positive, especially from representatives of the local and regional levels but also from government agencies, as well as private actors and industry.

Source: Adapted from OECD (2010), *OECD Territorial Reviews: Sweden 2010*, OECD, Paris.

Ineffective vertical and horizontal co-ordination from the central level can create difficulties for coherent public service delivery and sub-national policy including territorial and regional development and service delivery. This is due in part to the fact that sectoral policies can be compartmentalised and guided by narrow objectives, which may not take the broader policy context into account. In Estonia co-ordination responsibility rests with the Ministry of Interior/Regional and Local Affairs. The department itself is broken down into several units[15] (Ministry of Interior, 2010b), which may also face internal communications challenges. Local and regional development policy also rests with the Ministry of Interior/Regional and Local Affairs, as does spatial planning. The levers used to formally integrate the diverse policy areas that impact sub-national activity and performance do not seem to be used effectively, and given the role of personalism and informal ties in Estonian, these may be the only means currently available to overcome co-ordination challenges. Unfortunately they seem insufficient, evidenced by the fragmentation that characterises Estonia's sub-national relationships, both among and between central and sub-national actors.

The increased recognition of inter-dependencies and interactions among policy areas highlights the value of horizontal governance at the central level. Horizontal governance, therefore, can potentially improve resource allocation and service delivery by facilitating more integrated approaches to policy administration. Different mechanisms for strengthening national-level co-ordination are taken across OECD member countries (OECD, 2010h) (see Box 6.23), including co-ordinating structures and strategic planning.

Various models have emerged in OECD countries to improve the co-ordination of territorial and sub-national policies at the national level. These range from bodies charged with co-ordinating the activities of sectoral ministries to full-fledged ministries with broad responsibilities and powers that encompass traditionally separate sectors. Co-ordination through inter-ministerial committees and commissions is the simplest and most common instrument, and three characteristics of such bodies stand out (OECD, 2005a):

- *Formality/informality.* Some co-ordinating bodies are relatively informal, others are more structured. Austria, for example, has developed an informal approach that emphasises consensus building among different ministries, while Switzerland uses a more formal approach to policy co-ordination where ministries dealing with territorial development issues have to convene regularly in an inter-ministerial body.
- *Political level co-ordination.* The task of managing co-ordination across ministries – *i.e.,* chairing co-ordination bodies – is often a responsibility of the head of state, prime minister or cabinet. In the United States, the President's Cabinet is responsible for cross-sectoral

Box 6.23. **Selected mechanisms used to strengthen national-level co-ordination of sub-national policy**

OECD member countries are using numerous mechanisms to strengthen national-level co-ordination in multi-level governance. Three appear particularly relevant to the Estonian case:

- *Co-ordinating structures such as inter-ministerial committees and commissions*: This is one of the simplest systems for horizontal governance, as it is based on the existing government structure. Experience from OECD member countries indicates that a horizontal commission chaired by one sectoral ministry may be limited in pursuing multi-sectoral objectives and hinder full involvement of other ministries. Alternating the chairmanship among participating ministries or meta-ministerial leadership is one way to address this. The higher the leadership within these types of commissions, the stronger the incentives are to participate and the greater the engagement of the different actors. Examples of this type of co-ordination include the Ministerial Committee for Regional Policy in Denmark, the Presidential Committee on Regional Development in Korea, and the Cabinet Sub-committee on Rural and Regional Policy in Norway.
- *Strategic planning and programming including agreements, frameworks and instruments*: The formulation and implementation of national regional policy programmes and/or spatial planning can provide the impetus and framework for greater central co-ordination, and is widely used across OECD member countries. In many countries spatial planning is gradually moving from land-use regulation frameworks towards long-term strategic documents focusing on the co-ordination of diverse issues and interests across sectors, as well as between levels of government – and often incorporates monitoring, feedback and revision mechanisms. Examples include the National Strategic Reference Framework in EU countries, the National Spatial Strategy in Japan, and the Comprehensive National Territorial Plan in Korea.
- *Special units or agencies that provide planning and advisory support to help ensure policy coherence across sectors at the central level*: High-level "special units" have been created in several countries to ensure consistency among sectors. The closer such units or co-ordinators are to a chief executive, the greater the incentives are for co-operation across sectoral ministries. Examples include DATAR, which is directly linked to the Office of the Prime Minister in France, and the Austrian Conference on Spatial Planning (ÖROK) under the auspices of the Federal Chancellery. Special units under sectoral ministries include, for example, the National and Regional Planning Bureau of the Ministry of Land, Infrastructure, Transport and Tourism in Japan, and the Spatial Economic Policy Directorate of the Ministry of Economic Affairs in the Netherlands.

Source: Adapted from OECD (2010), *Regional Development Policies in OECD Countries*, OECD, Paris.

co-ordination; in Mexico, the Presidency; in Ireland, the Office of the Taoiseach; in the UK, the Office of the Deputy Prime Minister; in Austria, the Federal Chancellery.

- *Links with budget allocation mechanisms*. The participation of finance/treasury ministries and the link between the outcomes of co-ordination processes and budget allocation procedures is an important aspect.

Much of the discussion surrounding central level co-ordination and multi-level governance has strong reference to territorial and regional development. The government's consideration of the local-level challenges in Estonia must be viewed comprehensively, as a regional and territorial issue. Such a perspective is exceptionally relevant if greater

municipal co-operation (particularly through amalgamation) is an objective, as this can impact and be impacted by territorial and regional development planning.

Co-ordinating structures: Inter-ministerial commissions and committees

In Estonia, central-level co-ordination of sub-national policy requires reinforcement. Greater political and senior civil servant co-ordination is essential and could be achieved through the use of inter-ministerial committees. Such a mechanism could be beneficial for developing more seamless service delivery, as well as promoting a single government approach to sub-national policy design and implementation. In addition, the combination of both networks and working groups (see Chapter 4: "Taking a Whole-of-Government Approach in Public Administration") could make appropriate use of Estonia's effective informal co-ordination mechanisms while also bringing a degree of formality to processes and procedures. Such an approach, however, will only be effective if leadership for cross-sectoral policy areas – *e.g.,* sub-national matters, public service delivery, etc. – is clearly established, including decision making authority and co-ordination responsibility, with collective responsibility maintained for shared outcomes.

Some countries also augment cross-sectoral co-ordination mechanisms with the use of special units or agencies that provide planning and advisory support to help ensure policy coherence across sectors. This is seen in France, Japan, Norway and the UK, for example. Thus, among OECD countries the approach to sub-national co-ordination is structurally more integrated than what is currently seen in Estonia. Within Luxembourg's Ministry for Sustainable Development and Infrastructure, the territorial and spatial responsibilities of DATer are supported by a cross-sectoral Committee, and a multi-stakeholder Council. Denmark has established a Ministerial Committee for Regional Policy, led by the Minister of Economy and Business Affairs with members from eight sectoral Ministries. In addition, the co-ordination between the central and regional level is supported not only by legislation but also through partnership agreements (inter-governmental annual contracts) among each of Denmark's six Regional Growth Forums. The co-ordination with municipalities has reportedly increased in Denmark – as local authorities are prominent supporters of regional development measures, in part as funders, and also to a degree as implementers. While a federal country, in 2006, Switzerland launched a spatial planning reform across levels of government. By signing the "Convention for the Common Development for a Territorial Development Project" all three levels of government committed to work together to define a national concept, which would provide the basis for future co-ordinated action by actors at different levels. The concept is scheduled for completion in 2011, and is non-binding. Meanwhile inter-governmental relations concerning spatial planning, a complex affair in Switzerland, are addressed by the Council on Territorial Organisation (*Conseil de l'organisation du territoire* – COTER) (OECD, 2010h).

While co-ordinating bodies represent an important tool, decision-making power rests primarily with individual sectoral ministries that implement the policies. As such, while the planning stage is more or less well integrated, implementation is potentially fragmented. To overcome this, particularly in the case of regional policy, in some cases inter-ministerial co-ordination bodies have been empowered and given some responsibilities for implementation. The DATAR in France is an inter-ministerial body charged with ensuring co-ordination, but it also has a formal role in territorial development planning, decision making and policy implementation. In Italy, the Department for Development and Cohesion Policies within the Treasury Ministry has broad competence for programming and co-ordinating investments with particular reference to the Mezzogiorno regions (OECD, 2005a).

Another approach to sectoral co-ordination is to merge and combine departments in order to overcome departmental boundaries. This was an avenue pursued in Japan and the UK, for example (OECD, 2005a), and is coherent with one of the operational characteristics of small state public administrations where entities tend more often to merge than to split.

Strengthening strategic planning for a single government approach to sub-national policy

Regional co-ordination capacity is low in Estonia. One indicator is the little attention and low cross-sectoral support that regional development and the current Regional Development Strategy (see Box 6.24) appear to receive within the government. The Strategy is comprehensive, ambitious and aligned with current trends in regional development policy (see Table 6.11). However, it lacks collaboration and co-operation for implementation, and thus is unable to fully meet its objectives. Another indicator is the three- to four-year time lag in updating the Strategy's associated Action Plan. While the strategy may remain valid because the issues have not changed, the reality of addressing the issues based on the current plan may no longer be valid given the change in the economic situation. The plan requires revision based on the current economic context, the government's overall priorities

Box 6.24. **Territorial and regional planning in Estonia**

Estonia's territorial planning is currently defined by a spatial plan elaborated in the late 1990s and implemented in 2000. A new spatial plan is currently under development, led by the Ministry of Interior/Regional and Local Affairs. At the regional level, Estonia's Regional Development Policy Strategy 2005-15 was developed together with an Action Plan covering 2005-07. The Strategy was developed to meet the needs of EU demands for regional policy, providing the basis for Estonia's National Structural Reference Framework (NSRF) document. Although it has been used to prepare regional policy decisions, it has been inconsistently and incompletely implemented by the various stakeholders, and a subsequent Action Plan was never developed. Aware of this, Estonia is preparing a second Action Plan, which is slated for development in 2011. The 15 county development plans are loosely linked to the regional policy strategy and align to EU categories for funding eligibility.

County development plans are intended to ensure balanced development within the region. These must be in accordance with the central government's national priorities, such as competitiveness, as well as the Regional Development Strategy. County plans, however, have no legal basis and focus on land use, social infrastructure, and green corridors. Municipal development plans are overseen by the county; unlike county plans these do have a legal basis. Thus, if municipalities do not agree with the county development plan, they can decide not to participate in a regional initiative. If a Municipal Council does not agree with the project, the county cannot establish its initiative *(e.g.,* a wind farm) on municipal territory, and the county cannot override the decision of the Municipal Council. At the same time, counties supervise municipal plans, and municipalities check that their planning aligns with the county's development plan. If the local plan is different from what the county has in mind in terms of land use, then the two parties can discuss it. In extreme cases the County Governor can override local planning if necessary, but not decisions of Municipal Councils.

Source: OECD interviews.

(e.g., competitiveness and sustainability), the reality of how the government manages multi-level governance relations (with low co-ordination), and the fact that administrative reform has not taken place. It is reported that the Strategy will be revised in 2012. For a new plan to be successful, however, greater buy-in at the ministerial level may be necessary, and this would require high levels of co-ordination and collaboration in its development – applying a whole-of-government approach to building regional development policy, as well as other sub-national policy programmes and initiatives. In addition, there needs to be a clear link between the objectives of the new spatial plan (Estonia 2030) and those of any revised regional development strategy.

Luxembourg also provides an example of co-ordination mechanisms in planning that can reinforce a cross-sectoral approach, strengthen regional policy coherence, and build "buy-in". The Grand Duchy's territorial development policy is founded on the principles of co-ordination, co-operation and participation. It has incorporated these principles in its approach to territorial planning, developing an array of instruments, intervention tools, and mechanisms of supervision that facilitate rolling out an ambitious territorial development policy aiming to ensure a better spatial balance of activities. Co-ordination in territorial planning policy is both horizontal, integrating sectoral plans, and vertical, establishing a formal link between the local and national decision-making levels. Spatial planning policy is also based on the participation and co-operation of stakeholders, particularly the communes. Through sectoral programmes, it can ensure the horizontal co-ordination needed at the national level with other Ministries to develop the broad lines set out in the Master Programme (see Box 6.25) (OECD, 2007c).

Box 6.25. **The territorial planning framework in Luxembourg**

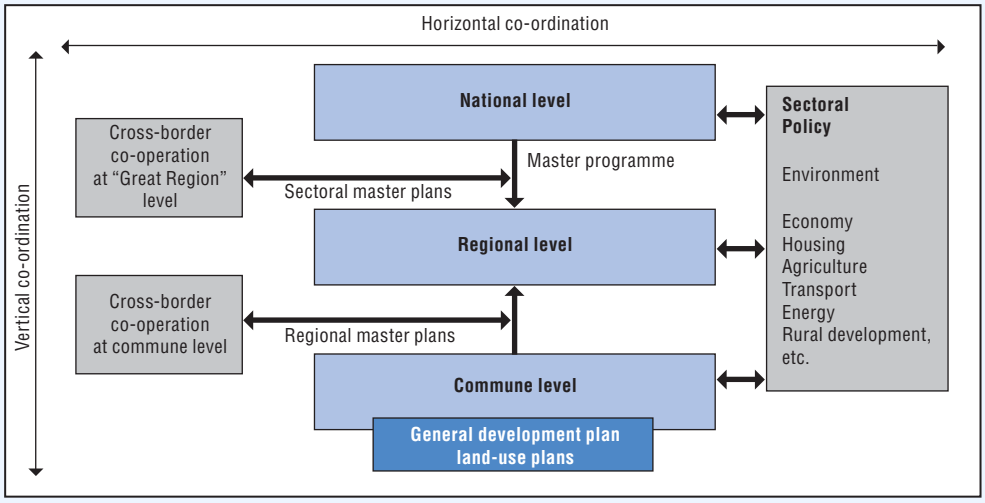
Luxembourg has developed a series of inter-linked territorial planning instruments that depend on and reinforce both vertical and horizontal co-operation (see the Figure below).

- *The Master Programme*: at the national level, the "Master Programme" is the main territorial planning instrument and policy guidance document that sets out broad directions for the future development of the country at different levels of government. It is the common basis for integrating sectoral policies and for providing a framework for regional policies and commune policies articulated in the General Development Plans, which are required to be compatible with the objectives of the Master Programme.
- *Sector Master Plans*: also at the national level, these are instruments that cover one or more sectors of activity or areas of government intervention, and clarify the national options for the sector or area concerned. They are designed to promote horizontal co-ordination and ensure the integration in national territorial planning policy of sectors with a spatial impact *(e.g.,* transport, housing, environment, mobile telephones, secondary education, waste, etc.).
- *Regional Master Plans*: intended as a means to facilitate vertical co-ordination, clarify and integrate national planning and development options with those defined at the commune level by Planning Region.* Regional Master Plans are prepared by joint working groups of representatives of the ministries concerned and representatives of the communes which are part of the Planning Region. Each plan drafted is subject to the approval of the commune councils of the region concerned, as well as to national level co-ordinating bodies (CSAT, and CIAT).

Box 6.25. **The territorial planning framework in Luxembourg** *(cont.)*

- *Local-level planning instruments:* among the various planning tools at the commune level would be mandatory "General Development Plans", as well as additional plans such as the Land-Use Plans for authorities to carry out major projects, and the Specific Development Plans for urban operations.

The principles of horizontal and vertical co-ordination for territorial development in Luxembourg



* Six functional planning regions established strictly for territorial planning purposes. These regions are discussed further in the chapter, under the subheading "Building the institutional conditions for regional policy development and implementation".

Source: Adapted from OECD (2007), *OECD Territorial Reviews: Luxembourg 2007*, OECD, Paris.

To support this strategic planning framework, Luxembourg's government has put in place a definitive and capacitated structure for co-ordinating the design, implementation and sustainability of regional planning. The Territorial Planning Directorate (DATer) is responsible for all territorial development measures, including finalising the draft of the Master Programme, the formulation of regional sectoral plans and land-use plans. It also defines mechanisms and procedures to be followed for planning in the communes as well as the approval of the communes' General Development Plans. Different countries may approach the degree of centralisation of planning differently, but what is particularly relevant for Estonia in this case is the co-ordinating body and consultative body that support DATer's activities. Co-ordination is ensured by the Inter-ministerial Committee for Territorial Planning (CIAT). This is headed by a chairman with 13 members delegated by each of the 13 ministries with responsibilities relevant to territorial development. Its main purpose, under the direction of the minister responsible for spatial planning, is to co-ordinate the work at the government level to prepare decisions relating to regional master plans, sectoral master plans, and land-use plans. The CIAT also contributes to framing the Master Programme and supplementary regional and sectoral programmes, and reviews the opinions given by the Commune councils on planning these programmes (OECD, 2007c).

In addition, there is a Superior Council for Territorial Planning (CSAT) with advisory powers. It has a maximum of 19 nominated members, who come primarily from industry organisations. Four seats are for representatives from the umbrella association for towns and communes. The Council's purpose is to advise on the draft of the Master Programme and the draft regional and sectoral Master Plans. It also advises the government on broad options or major problems in spatial planning (OECD, 2007c). This is a good example of expanding the stakeholder base in regional planning, broadening perspective, and creating space for greater innovation in identifying solutions to regional challenges, including competitiveness and service delivery.

Thus, different from Estonia, the institutional co-ordination mechanism used in Luxembourg is cross-sectoral. At one level it is technical (CIAT) at another it is advisory (CSAT). Estonia has experience with such bodies, for example when developing its Sustainable Development Strategy and the associated indicators. This multi-stakeholder approach permits all relevant actors to have a voice in the planning process, take responsibility for sectoral implementation, and to be accountable for outcomes. It also reinforces a single government approach to the design and execution of ongoing territorial and sub-national planning.

Building the fiscal relationship

Finally, consideration should be given to building the fiscal relationship between levels of government. The implementation of regional and local development policy risks being less effective than desired because there is no link between county development plans and state budget allocations, limiting the implementation capacity and effectiveness of county development plans. An even more important factor, particularly given the large role of EU funds at the local level, is the fragmented, micro-level, project-oriented approach to EU fund allocation. Currently, there is a small portion of state-level budget allocated to regional development (different from the county development plans). For the most part however, the main financial instruments behind Estonian regional development policy are European Structural Funds (primarily the Regional Development Fund) as well as other EU and non-EU funding sources. Funds are allocated to individual projects submitted by local governments. Priority areas are set, counties are given an envelope of funds, and once municipal proposals are approved by the central level, they go to the county-level selection committee which determines which projects will be funded. Monies are disbursed according to order of priority as established by the committee. The process appears sound. However, there is a high risk for poorly targeted, low-value-added investment. This arises from two situations. First is fragmentation in the management of EU funds. While this may not be unusual in EU countries, effective management requires strong co-ordination capacity. EU-sourced funds are managed by different ministries, including the Ministry of Interior/Regional and Local Affairs, the Ministry of Education and Research, and the Ministry of Economy and Communication. Disbursement, however, rests primarily with Enterprise Estonia.

Second, much of the funding goes to infrastructure, such as schools, roads and transportation systems. This has been a conscious decision on Estonia's part due to a need to upgrade infrastructure. However, the recipient municipality's wealth is not taken into account. Thus, the poorest municipalities might not be able to fund their own share of the grant and would be refused the funds. For those that can afford the matching portion, the question of sound investment remains. For example, if the reality is that schools may need to close, is the investment in a new school building a sound one in the long run? Roads need development,

this is unquestionable, but unless this goes hand-in-hand with a broader vision as to which roads, to where, and the desired gain – *i.e.,* to facilitate tourism, provide a new market for municipal goods or services, make medical care more easily accessible for the aged, etc. – there may be some roads to nowhere. Finally, there is a question of over-investment. Many Estonian municipalities face the need to modernise their water provision and water treatment systems, for example. EU funds are also available for this. There are reported cases, however, where the technology used is unaligned with the real need and long-term maintenance capacity of the municipality, leading to the use of more sophisticated technology than is necessary or that the municipality will be able to maintain over the long run.

Moving forward, care needs to be taken to avoid "roads to nowhere". Funding allocation is a competitive process primarily among municipalities. This can work against efforts to build local co-operation – running against the intention of EU funding, which is to promote co-operation and regionalisation. Thus, linking EU funding allocation more clearly to programmes associated with regional development goals, rather than individual municipal-level projects, would be a stronger and more strategic approach.

Estonia's objective should be to bring coherence into regional planning by building a single government approach with the resources necessary to realise its goals. Continued funding of regional development with a combination of EU (co-financed) and central government funds makes sense. There is, however, room for greater effectiveness. Estonia could increase the contribution of central-level funds to regional development and link these to the state budget, demonstrating support for territorial and regional development suited to Estonia's ambitions and its context. Complementing its broader European role, re-designing how EU funds are allocated taking a programme- rather than a project-based approach, could improve investment outcomes, and minimise the competition between municipalities for project funds.

Elaborating and strengthening the tools for central/sub-national co-ordination can help build capacity at all levels of government

In addition to central-level structural mechanisms, a wide variety of tools are available to enhance the central/sub-national relationship (see Table 6.9). Many of these focus on enhancing vertical co-ordination and building capacity, especially for municipalities. Such

Table 6.9. **Some tools for bridging the co-ordination and capacity gaps**

Tool	Examples of tool-form or where tool is used
Contracts	Canada, European Union, France, Italy
Performance measurement and transparent evaluation	Norway, United Kingdom, United States
Grants, co-funding agreements	All countries: general purpose grants *versus* earmarked, equalisation mechanisms
Strategic planning requirements, multi-annual budget	Together with investment contracts
Inter-municipal co-ordination	Mergers (Denmark, Japan); inter-municipal co-operation (Brazil, France, Spain)
Inter-sectoral collaboration	One ministry *versus* inter-ministerial mechanisms (Finland, France)
Agencies	Canada, Chile, United Kingdom
Experimentation policies	Finland, Sweden, United States
Legal mechanisms and standards setting	All countries, but more or less implemented
Citizen participation	A question of degree
Private sector participation	From strategy design to… vested interest
Institutional capacity indicators	Italy for the sub-national level

Source: OECD (2011), forthcoming, *Governance of Public Policies in Decentralised Contexts: The Multi-Level Approach*, OECD, Paris.

tools range from binding to soft, and can include: legislation and laws; formal contractual arrangements; co-ordinating bodies; judicial review; informal or *ad hoc* meetings; performance measurement; and other mechanisms such as experiments or pilot programmes. OECD governments use these tools to differing degrees – legislation and laws tends to be the most popular followed by co-ordinating bodies[16] – and often a combination of at least two of these mechanisms is used (Charbit and Michalun, 2009). In addition, many have some indicator system in place for monitoring sub-national service provision, as well as incentive structures to promote co-operation (Charbit and Michalun, 2009).

Laws and legislation, contracts, and standard setting

In Estonia, laws and legislation – the most binding of the tools – appears to be most frequently relied upon to manage and co-ordinate central/sub-national relations. There are several benefits to legislation, including the ability to mandate new resources as well as new responsibilities, and to reduce overlap in responsibilities between the national and sub-national levels (Charbit and Michalun, 2009). Laws and legislation, however, also introduce certain rigidities in the system which can limit activity as needs evolve. This is the case with County Municipal Unions for example, which play an increasingly important role in promoting municipal co-ordination and service delivery locally and within counties. As legal entities, these are non-governmental organisations. However, to increase their scope of activity and build their capacity to deliver services on behalf of their member municipalities, not only would they require agreement from the local authorities, but they would also need a change in their legal status, as NGOs do not have the right to set guidelines that could facilitate co-ordination *(e.g.,* public transportation fares and times in a county). To do so would require a change in statute to a public or quasi-public entity, which could lead to an ability to receive public funds.

Thus, while laws and legislation are popular and helpful, utilising more flexible means to manage central/sub-national relations may facilitate adjustments as relations and needs evolve. Other commonly used vertical co-ordination mechanisms are contracts between central and sub-national entities. These are often used to help manage inter-dependencies and solve some institutional weaknesses. In contractual arrangements, parties commit either to take action or to follow the guidelines of mutually agreed upon decision mechanisms wherein decision-making rights have been transferred between parties. Contracts enjoy a high degree of flexibility of use and diversity of application, permitting governments to re-organise rights and duties without requiring a constitutional or legislative change (Charbit and Michalun, 2009).

The Ministry of Interior/Regional and Local Affairs has developed framework contracts for central/sub-national agreements relating to ICT. It is planning to extend these to other areas. The use of contracts or service agreements appears low, however. There is some evidence of their application between agencies and municipalities – for example, the Tax and Customs Board is partnering with the City of Tallinn to provide the tax collection infrastructure for the city sales tax that was introduced on 1 June 2010. In addition, the Board has contracts with most municipalities to provide tax information for use in calculating benefits. There is room to use contracts more frequently, as these can also be of value for clarifying accountability structures, establishing performance measurement parameters and indicators, articulating expectations for quality standards or levels, and reporting output and outcomes.

Performance measurement and indicators

Indicator systems promote learning and orient stakeholders towards results, thereby addressing information asymmetries that arise between levels of government. They are also effective tools for reinforcing accountability of stakeholders at all levels of government by improving transparency. When carefully coupled with specific incentive mechanisms and realistic targets, indicators can stimulate and focus actors' efforts in critical areas. Thus, they help promote capacity development and good management practices. Assessing a variety of such performance indicators systems has led to a better identification of benefits and "costs" attached to their implementation (OECD, 2009e).

Individual ministries in Estonia maintain various indicator systems for performance measurement. For example, the Ministry of Education gathers information and data regarding schools, students, exam results, etc.; the Ministry of Social Affairs collects a wide variety of relevant analytical data; the Ministry of Justice also gathers data from and for municipalities – for example, on crime levels (which are low) – that can be relevant to local authorities. These indicator systems are developed to differing degrees, and it is also unclear as to how the information generated is fed back to municipalities and used by the central and local levels to improve public service delivery, performance and quality. What is missing, therefore, is a system that can help disseminate information across levels of government, build capacity in its use, help actors identify objectives based on the data, and improve government effectiveness – be it administrative, the use of financial resources, or in service delivery. Such information can be particularly important when contracts are negotiated or co-operative partnerships are established, as performance measurement information can help each party understand the capacity level of the other, and develop an arrangement where co-ordination is optimised based on capacity in terms of resources and skill (Charbit and Michalun, 2009). This has been one of the benefits Norwegian municipalities see from Norway's KOSTRA system, which publishes the data results electronically, within a month of receipt from the municipalities (see Box 6.26) (OECD, 2009e).

Box 6.26. **Norway's performance indicators system (KOSTRA)**

The Norwegian KOSTRA system in an OECD-area best practice in terms of performance monitoring of local services. It is an electronic reporting system for municipalities and counties. It can publish input and output indicators on local public services and finances and provide online publication of municipal priorities, productivity and needs. KOSTRA integrates information from local government accounts, service statistics, and population statistics. It includes indicators of production, service coverage, needs, quality and efficiency. The information is easily accessible via the Internet and facilitates detailed comparison of the performance of local governments. The information is frequently used by local governments themselves and by the media and researchers. Although individual local governments could use KOSTRA more efficiently *(e.g.,* by systematic benchmarking), the system has helped facilitate comparisons of municipalities, thereby promoting "bench-learning" or "bench-marketing."

Source: OECD (2010), *OECD Territorial Reviews: Sweden 2010*, OECD, Paris.

Estonia may wish to consider what other OECD countries undertake with respect to the various methods and approaches to developing and implementing indicator systems (see Table 6.10).

Table 6.10. **Examples of indicators used by different OECD countries to measure sub-national service**

Category		Examples	Country/system
Context	Demographics	Population, gender, age, marital status, births, deaths	
	Service context	Irregularities in water distribution	Italy (regional policy)
		Per capita average expenses for theatre and concerts	
		Air pollution due to transportation	
Inputs	Materials	Municipal nursing home beds	Finland
	Staff	Number of required staff for the service	Turkey/BEPER
		Numbers and qualifications of teachers	Finland
	Finances	Net operating expenditures	Norway (KOSTRA)
		Education expenses	Finland
		Deflated expenditures and revenues	The Netherlands
	Policy effort	Capital expenditure by level of government and sector	Italy (regional policy)
		Preparation and approval of territorial and landscape programming documents	
Outputs	Policy outputs	Number of inhabitants served	Turkey/BEPER
		Amount of solid waste collected	
		Visits to physician, dental care visits	Finland
		Building permits issued	Australia
		Number of passports, drivers licenses issued	The Netherlands
	Service coverage	Per cent of aged inhabitants receiving home services	Norway (KOSTRA)
		Per cent of children enrolled in kindergarten	
		Recipients of social services as a per cent of the population	
	Efficiency	Government funding per unit of output delivered	Australia
		Spending efficiency: achievement of payment level equal to 100% of previous year's financial appropriation	Italy (regional policy)
		Children 1-5 years in kindergartens per full time equivalent	Norway (KOSTRA)
		Number of children per teacher	Sweden (education)
		Cost per user	Sweden (elder care)
Outcomes	Policy outcomes	Education transition rates	Norway (KOSTRA)
		Response times to structure fires	Australia
		Improved language skills of immigrants	The Netherlands
	Effectiveness	Effectiveness of outputs according to characteristics important for the service (*e.g.,* timeliness, affordability)	Australia
		Disease-specific cost-effectiveness measures	Finland (hospitals)
		Passengers	The Netherlands (transport)
		Share of completion of students in secondary schools	Sweden (education)
	Equity	Geographic variation in the use of services	Finland (hospitals)
		Units per 1 000 members of target group	Germany (Berlin)
		Recipients of home-based care as a share of inhabitants in different age groups	Norway (KOSTRA)
	Quality	Number of days taken to provide an individual with needed assistance	The Netherlands
		Number of different caregivers providing home care for the elderly to a single individual	Denmark
	Public opinion	User satisfaction with local services	The Netherlands

Source: Charbit and Michalun (2009), "Mind the Gaps: Managing Mutual Dependence in Relations Among Levels of Government", *OECD Working Paper on Public Governance*, No. 14, OECD, Paris; OECD (2006), "Workshop Proceedings; The Efficiency of Sub-Central Spending", *OECD Fiscal Network Workshop on Performance Indicators and Local Government Collaboration*, OECD Network on Fiscal Relations across Levels of Government, Internal document, OECD, Paris; OECD (2008), "Promoting Performance: Using Indicators to Enhance the Effectiveness of Sub-Central Spending", *OECD Network on Fiscal Relations across Levels of Government Working Paper*, No. 5, OECD, Paris.

Co-ordinating bodies for central/municipal relations

Co-ordinating bodies are critical drivers for building capacity and sharing good practices, especially at the sub-national level. They often serve as forums for overcoming communication and dialogue challenges. In addition, co-ordinating bodies can help align interests and timing, especially with respect to implementing public policy at a horizontal level. While co-ordinating bodies do not necessarily promote the physical integration of government bodies or municipalities, they can help consolidate and disseminate knowledge about good practices in each. In Australia, the Council of Australian Governments (COAG) serves this function in a vertical dimension. In the Czech Republic, the Union of Municipalities and the Association of Regions have representatives on the Board for Regulatory Reform and on the Board for Effective Public Administration. These Boards co-ordinate projects relating to the modernisation of public administration, and they are the central bodies responsible for the quality of impact assessment studies (Charbit and Michalun, 2009).

Like many OECD countries, Estonia's two national-level municipal associations – the Association of Estonian Rural Municipalities and the Association of Estonian Cities[17] – were established to serve as partners for both the central and local authorities, negotiating matters with the central government on behalf of local members. However, given the strength of the state, and the lack of financial capacity of the municipalities, as well as the fact that not all municipalities are members of one or the other association, it is hard for the associations to be as effective as desired in vertical negotiations, particularly on financial matters – though they may have greater success on policy issues such as the Basic and Upper Secondary Schools Act. The associations themselves are fragmented in their visions, and thus do not always present a united front. This reduces their credibility *vis-à-vis* the government and their effectiveness *vis-à-vis* their members.

Estonia's municipal associations face a capacity challenge, primarily in terms of human and financial resources. This may be preventing them from developing as full and highly effective partners for their sub-national members. At the same time, they have extensive and valuable knowledge and information about the functioning, management and financing of municipalities. This should be put to better use for co-ordinating the central/sub-national relationship and building capacity. Under discussion among the associations is the potential for a merger. Understandably this can be difficult and occasionally contentious, but Estonia's national municipal associations may wish to follow the lead of Finland in this area, and unite both entities in order to build greater mass and become a stronger partner for all levels of government.

Taking territorial needs into account for service delivery and regional development

Thus far in thinking about its service delivery challenges and requirements, Estonia has focused predominantly on questions of scale at the municipal level. However, in doing so, it appears to be missing the need to take local and regional specificities into account – notably rural and urban differences – as well as the potential complementary value-added of using regional and territorial development policy to support a strategy for both sustainable growth and service demand.

Matching public services to local needs

Estonia has approached the concept of equitable service delivery from the perspective of a citizen's ability to receive (or expect to receive) all services no matter where they choose to live. This "one-size-fits-all" approach to the allocation of municipal competences makes all municipalities responsible for the same tasks regardless of their size.[18] Legally, the smallest municipality, Piirissaare, with a population of 105, is responsible for providing all of the same services as Tallinn, with a population of over 407 000. Realistically, local governments are not all able to provide all services to citizens, much less services of equal quality. It is also unrealistic to expect services available in Tallinn to also be available in a small town. This is the case with certain hobby schools or extra-curricular activities, for example.

Most of Estonia's municipalities are small: over 65% have less than 3 000 inhabitants, and over 80% have fewer than 6 000 inhabitants (see also Figure 6.12). While the average municipal population is approximately 5 800 inhabitants, the *median* population is approximately 1 740[19] and about 47% of Estonia's municipalities are at or under this median level. Tallinn and Tartu combined are home to over one-third of the country's population, with the majority of this figure living in Tallinn. From a public service standpoint, this indicates that Estonia faces the challenges associated with rural areas and a need to balance this with the weight represented by a dominant capital city and region (*i.e.,* Tallinn and Harju County) in terms of population size and contribution to overall national GDP.

Across OECD countries, it is possible to identify systematic differences in services – availability and quality – between urban and rural territories. In general, rural areas receive fewer and weaker services when compared to urban ones. These differences, however, are problematic only if equality of service provision and access is the unit of analysis. Successful public service delivery can depend on both the appropriateness of the mix of services delivered to citizens, and on citizen satisfaction with these services (OECD, 2010i). While equity of access is important, it may be more important that the services available are of good quality and meet the needs of citizens and businesses in that area. The central government must be sufficiently flexible in supporting municipalities' ability to bundle services appropriately and to adjust the mix when required.

There is also the issue of equity *versus* efficiency to consider, particularly as some services are more costly to deliver in rural and remote areas. Public service availability is critical for development, not just for equity considerations but because they are a pre-condition for unlocking the development potential of territories and countries, as well as providing a foundation for the well-being and productivity of a country's residents (OECD, 2010i). Compounding the issue, government and markets have extended the variety of services that are broadly available to most urban members of society. This causes a perception of a growing urban/rural service availability gap. It is this combination, of perceived rights to equal treatment and the existence of an ever growing set of services, which is at the heart of the rural service delivery problem.

In many rural areas worldwide, especially the most remote, certain services are not available or are available at considerably higher cost and/or lower quality than in centre or urban locations. Although very few national governments explicitly guarantee uniform availability of public services across their territory, a growing proportion of the public perceives that spatial equality of access should be part of the statutory rights of citizens. Generally, these specific rural-area service delivery challenges include: access; an ageing population; distance, critical mass and density; a decline in central government subsidies;

an increasingly diverse population; less than optimum technical capacity; complex national and international supply chains; limited choice; and weaker communication networks (OECD, 2010i).

Some experts believe that the rural service delivery problem will remain unsolved without a "strong value position" that clearly affirms that "citizens have a right to services no matter where they live." Others feel that by choosing to live in more remote or less-connected regions, citizens have agreed to "less than equivalent services." But no matter the view, standards are important because the difficulties in accessing public services can generate or perpetuate unequal capacities and life chances. Cost, efficiency, effectiveness, and tradeoffs may conflict with service delivery frameworks that lack the full understanding of the value of social objectives, geographical coverage and minimum standards that are non-negotiable to citizens. Thus, public policies should ensure that the determination of which service for which region considers the acceptable equity *versus* efficiency trade-offs (OECD, 2010i).

Tailoring service delivery requirements to population needs may help effectiveness objectives and build citizen satisfaction

Municipalities are faced with a need to make choices about the bundle of goods and services they can afford to provide. While ideally all communities should be able to provide all goods and services equally, the reality is they cannot and may not need to due to lack of demand for relatively rare services. Decentralisation and devolution of competences puts municipalities in the driver's seat when determining which services are needed by the community. In Estonia, however, it is a "double-edged sword": on the one hand, municipalities have the freedom by law to "… independently organise and manage local issues pursuant to law and based on the legitimate needs and interests of the residents… and considering the specific development of the rural municipality or city" (Republic of Estonia, 1993) and, on the other, they have the obligation to deliver on the competences as defined by the *Local Government Organisation Act* (see endnote 18). If they are not able to deliver on these services, ideally at an appropriate quality level, then technically they are not fulfilling their legal obligations to the state and citizens.

Decentralisation does not absolve government, either central or sub-national, from ensuring public service quality, but currently Estonia does not have well-established quality standards in many service delivery areas, such as care for the elderly (see Chapter 8: "Case Study Two: Social Services for the Elderly in Estonia"). Municipalities generally have leeway to determine the level of quality for the services that they finance. The result is uneven quality for similar services across the territory. In addition, since municipalities are concerned with providing as many of the mandated and demanded services as they possibly can, in a tighter budget context, not only are services cut, but service quality also suffers.

When confronted with the question of "what services to provide?" there must be consideration to the basic public services that individuals in each country are entitled to receive, irrespective of their economic and social status, and location. This set of basic services will differ by country. Water, waste management and electricity are all relatively standard offerings, education can vary by level of schooling, and healthcare and social services face greater diversity with respect to degree of government responsibility. There is no established or universally defined set of basic or statutory public services. In some countries these are defined constitutionally, in others through laws and acts, and generally through a combination of such means. However, in most OECD countries, services that are statutory entitlements show fewer delivery gaps, even in rural areas. For example, a study

Box 6.27. **Improving public service quality in decentralised contexts**

Estonia has had difficulty setting quality-based standards for public services. The governing idea has been that municipalities are best placed to establish these based on local factors and resource considerations. This, however, can lead to discrepancies in service quality by municipality, which, in turn, can create large disparities and penalise the residents of poorer or more remote localities. Countries approach standard setting in a variety of ways, and can use national-level mechanisms that impact how a service is delivered at a local level, both indirectly and directly. The United States and Singapore, among many countries, have national accreditation programmes for social service workers which can ensure a standard of training. Ireland has established national quality standards for residential services for people with disabilities, and in the UK, social services provided by local authorities with competences in this area have minimum standards that must be met, set by the Department of Health and monitored by the Care Quality Commission. Also in the UK, the Local Better Regulation Office was established by the Government to improve the capacity of local authorities to enforce environmental health, trading, and licensing standards (Charbit and Michalun, 2009).

Quality of care can also be positively influenced though financial incentive mechanisms. For example, in the US, Family Day Care Homes (FDCH) – childcare facilities in the private homes of individuals – must meet certain health and safety standards above the established minimum which all Homes are obligated to meet in order to be eligible for federal subsidies that reimburse meals served in the FDCH. The incentive for the operator is to receive a subsidy, but in order to do so they must meet federally established quality criteria. This approach provides freedom of choice for the operators to meet the standards set. If they do meet them, then they are rewarded with eligibility for a meal subsidy. If they do not want the subsidy, they can elect not to meet the standards.

undertaken in the Calbria Region of Southern Italy showed that while basic healthcare did not show great disparities in terms of access, providing access to more specialised services to less mobile people such as the elderly was quite difficult. Thus, distance and territorial availability do matter for certain population groups (OECD, 2010i).

This public service delivery dilemma could be addressed, in part, by better targeting services provided (*i.e.,* targeting to community needs and ability to use the services provided). Such targeting could be undertaken collaboratively among the central, county and local levels of government. Plans such as the *Social Infrastructure of the County 2008-15* for Pärnu County are a step in this direction, and have been completed for all counties. The plan examines service availability on a county-wide basis and presents proposals to meet shortfalls or strengthen key service areas. These proposals include amending current rules; ensuring service delivery in new or innovative ways; changing boundaries of local governments; assuring certain types of services; altering the financing system for certain services. The question then is which services to provide, by whom and how?

In order to manage rural/urban policy and service delivery challenges, Estonia may need to think about the appropriate mix of services in these types of areas, and clearly articulate the competences ascribed and methods of delivery, making them relevant and realistic according to citizen-based needs and municipal capacity. Tallinn, Rakvere and island communities, for example, demonstrate variation in need and resource capacity. While plans such as the county social infrastructure plans move towards this, they do not

address competence allocation and municipal capacity to deliver on these. Greater involvement on the part of the central government may be necessary in terms of guidance for matching competences to capacity. This could be one step towards aligning service delivery expectations and meeting urban/rural type service delivery challenges and opportunities, as well as municipal capacity.

If carefully cultivated, Estonia's territorial advantages could overcome its challenges

Among the territorial challenges Estonia faces are disparities in regional economic productivity, an ageing population, and unemployment. Each of these brings with it a set of potential inter-related public policy concerns: building economic competitiveness across the territory, thereby releasing some of the productivity pressure from the Tallinn City region; meeting the social service and healthcare demands of an aging population while still catering to the needs of Estonia's children, particularly for families who choose to live outside Estonia's urban and county-centres; ensuring fiscal capacity to fund public services despite a declining tax base; the strains of unemployment on social insurance, on labour policy, and on overall citizen well-being, economically, socially, and psychologically.

Estonia has a key territorial advantage, which should be nurtured: a relatively even distribution of its working-age population across the territory (see Annex B). While the numbers may be hard to maintain in the short run given the ageing population and low birth rate, through its new spatial planning initiative Estonia could begin reinforcing territorial (*i.e.,* spatial including infrastructure, economic, labour, social) policies aimed at maintaining this distribution as much as possible, or even improving it over time with people choosing to live outside of urban centres. Otherwise, the risk is greater migration towards strong centres, particularly Tallinn, or emigration. This would result in a further reduction of municipal capacity given de-population, and increased remoteness for certain areas.

Given Estonia's size, improving competitiveness should include unleashing the potential of the full territory. This can be accomplished both through spatial planning and also with a regional development policy that stresses building the country's place-based assets. Such an approach could emphasise various economic growth engines *(e.g.,* the service sector, industry, agriculture) and cultivate them as appropriate given unique regional endowments. This could include: building on Estonia's efforts to foster the growth of a knowledge-based economy; building the service sector, including tourism in rural areas; encouraging the growth of SMEs outside of urban or county centres; re-evaluating Estonia's approach to industrial policy by identifying where there is value added, what can be developed further in the long term, and how to achieve short-term gains; and promoting innovation policy for all sectors, including agriculture.

Aligning territorial vision and regional development

Comprehensive regional policies are increasingly regarded as complementary to national economic and structural policies by helping to generate growth in regions. The paradigm shift of regional development policy thus involves new objectives, a new geographical scope, new governance and new policy instruments (see Table 6.11). The co-existence of "old" and "new" paradigms can be observed in most OECD member countries, as a paradigm shift is an ongoing transition process which takes time. Regional policy based on the new paradigm is relatively recent compared to regional policy based on the old paradigm and sectoral policies. In addition, many countries have adopted the new paradigm in their policy objectives, but its implementation remains much more

challenging. It must be highlighted that sometimes changes to policy statements have not accompanied changes in policy instruments. In such cases the change is primarily rhetorical, without significant impact on policy or policy results.

Table 6.11. **Paradigm shift of regional development policy**

	Old Paradigm	New Paradigm
Problem recognition	Regional disparities in income, infrastructure stock, and employment	Lack of regional competitiveness, under-used regional potential
Objectives	Equity through balanced regional development	Competitiveness and equity
General policy framework	Reactive to problems: compensating temporally for location disadvantages of lagging regions, responding to shocks (*e.g.,* industrial decline)	Pro-active for potential: tapping under-utilised regional potential through regional programming
• Theme coverage	Sectoral approach with a limited set of sectors	Integrated and comprehensive development projects with wider policy area coverage
• Spatial orientation	Targeted at lagging regions	All-region focus
• Unit for policy intervention	Administrative areas	Functional areas
• Time dimension	Short term	Long term
• Approach	One-size-fits-all approach	Context-specific (place-based) approach
• Focus	Exogenous investments and transfers	Locally based assets and knowledge
Instruments	Subsidies and state aid (often to individual firms)	Mixed investment for soft and hard capital (business environment, labour market, infrastructure)
Actors	Central government	Different levels of government, various stakeholders (public, private, NGOs)

Source: OECD (2010), *Regional Development Policies in OECD Countries*, OECD, Paris.

An Estonian regional development policy should be the implementation mechanism of an articulated territorial strategy. Thus, on the one hand it should be Estonian in context, helping meet uniquely Estonian goals for its territorial, economic and social development. On the other hand, as an EU member, Estonia must continue to take EU requirements, opportunities and incentives into consideration. Regardless of how it chooses to move forward, a whole-of-government and ideally whole-of-society agreement on what Estonia should look like territorially is essential to sustainably address service delivery challenges. Regional development policy could help tackle service delivery bottlenecks in terms of cost, effectiveness and quality. Currently, regional policy in Estonia seems to be in place because of EU expectations, and required for structural and cohesion funds. There is a Regional Development Strategy developed for the EU, and an out-of-date Action Plan. This Strategy was comprehensive and ambitious, requiring a degree of cross-ministerial commitment and co-ordination that is not aligned with Estonia's current capacity.

Building the institutional conditions for regional policy development and implementation

Valid arguments have been made that Estonia lacks the institutional conditions (Estonian Co-operative Assembly, 2009) to implement place-based regional development policies. This is highly relevant, as such policies require effective sectoral (*i.e.,* among line ministries) and vertical co-ordination – particularly to ensure policy coherence and investment sustainability (Estonian Co-operative Assembly, 2009). This could be overcome, at least in part, with greater integrated co-ordination at the central level, as explored earlier. In addition, arguments have also been made that Estonia's 15 counties lack the

critical mass necessary to implement regional policy, and especially a place-based strategy. However, this argument restricts the scope of activity to areas within administrative boundaries without taking into consideration functional areas.

Functional areas are those that may overlap administrative boundaries but will group different communities or other administrative units together for a variety of purposes. The EU's NUTS3 classification in Estonia is an example. These are statistical regions in Estonia and have no administrative function for either central or sub-national government levels. While Estonia's 15 administrative units (counties) may indeed be too small in terms of surface area, population and GDP for a comprehensive regional development strategy, by developing functional areas for regional planning, Estonia may be able to overcome the mass question, and leave its current deconcentrated administrative structure intact, should it wish to do so. This could aid in firmly establishing place-based regional development while also building the scale necessary for such an approach to be warranted.

A functional area approach was taken by Luxembourg for regional planning and development. For *territorial administrative* purposes, the country is divided into: three districts each led by a district commissioner appointed by the Grand Duke and under the authority of the Ministry of Interior to serve as intermediaries between the central government and the communal authorities (municipalities); 12 cantons with no administrative structure; 116 communes. Meanwhile, for *territorial planning* purposes Luxembourg introduced six functional "Planning Regions," established through the Master Programme for Territorial Planning which itself is based on the Territorial Planning Act of 21 May 1999. These "Planning Regions" do not correspond to administrative boundaries, but were established on the basis of geographic and economic considerations as a means to facilitate the territorial planning in the context of a more balanced spatial development. They play a role in the territorial planning framework discussed earlier in this chapter (see Box 5.2) and demonstrate their own set of place-based characteristics: the North, West and East are predominantly agricultural, though the East is mixed; the Centre-North is more pronounced in urbanisation trends; the Centre South is the capital region; and the South is an urban and industrialised region (OECD, 2007c). Taking such a functional approach to territorial boundaries may help Estonia increase the effectiveness of its regional policy planning and implementation.

Conclusion

Estonia is not alone in the challenges it faces with respect to building service delivery capacity and quality. It is a complex matter in any country. OECD members share the need to grapple with the definition of basic public service sets, rural *versus* urban service needs and delivery, decentralisation, sub-national finance, mergers *versus* greater co-operation, and ultimately the outcomes of sub-national policy in terms of citizen well-being. In Estonia, sustainably addressing such concerns as seamless public service delivery, changing demographics, and municipal sustainability will require improved co-ordination at the national level, a flexible but well-defined policy for building municipal co-operation, and an approach to territorial and regional development that is not divorced from the concerns of municipal sustainability.

Estonia may wish to draw from the numerous examples provided in this chapter, applying them both to territorial and regional development as well as to the broader spectrum of sub-national policy, including that relating to municipalities. Doing so would entail re-evaluating how Estonia co-ordinates its multi-level governance relations, placing

greater emphasis on increased cross-sectoral activity at a central administrative level *(e.g.,* technical and senior civil service) as well as at a political level. "Buy-in" could be more easily built, facilitating implementation, accountability, and performance measurement. It would also improve policy coherence among sectoral ministries and could be a move towards ensuring that regional and local development planning help to not only promote sub-national interests but also to advance broader territorial aims. This would bring a single government approach to public service delivery and multi-level governance.

Notes

1. Estonia lowered the income tax rate from 26% in 2004 to 21% in 2010. The government plan was to drop the income tax rate to 18% by 2012 but the current economic crisis has led this to be postponed.
2. These are non-weighted averages of municipalities. The weighted average rate (weighted with taxable value of land) for land tax in 2009 is 1.6%.
3. Land tax revenues have increased also because previously untaxed properties have become subject to land taxation.
4. Municipalities have some consideration on less significant taxes such as a local sales tax and a boat tax, currently in use only by the City of Tallinn and which may be overturned by the government.
5. This takes into consideration all budget revenues.
6. Compared to the implementation of equalisation in other countries it seems odd that the municipalities that are in a more favourable situation (wealthy with low service needs) do not contribute to the funding of the grant.
7. The municipalities with a very big difference between costs and revenues could contribute by paying an equalisation fee.
8. The term business case refers to a communicated rationale for a reform/project/change, providing the vision and outcomes to be achieved, the methodology for achieving them, a cost/benefit analysis, impact assessment, engagement strategy and evaluation framework. While commonly used and understood in public sector ICT units a way of showing expected return on investment, this concept has been slow to penetrate into the Estonian public administration at the central and sub-national levels as a means to guide decision making on sub-national administrative change, public sector investment, and as a basis for evaluating project success.
9. Estonian population statistics cite two municipal population figures, with and without migration. The effect of migration can be quite big for some municipalities. For example, for Viimsi municipality (a municipality bordering the City of Tallinn) in 2008 the population with migration was twice as big as the population without migration (source: *www.stat.ee/33685*).
10. The principles of municipal amalgamations and the merger grants are established in the *Local Government Merger Act* (adopted in 2004). *www.siseministeerium.ee/public/LGinEstonia2005_20070322090339.pdf*.
11. In 2010, Finland indicated that it may move towards obligatory horizontal co-operation among municipalities for the creation of health-service catchment areas, as the current approach is not yielding the desired results.
12. Sweden currently has 21 counties, a number which has not changed significantly since the late 17th century (OECD, 2010k).
13. The Steering Committee for Joint-Government Co-operation (STS) was established in 2005 as Denmark's e-government decision-making body. It is comprised of the permanent secretaries of the Ministries of Finance, Science Technology and Innovation, Economic and Business Affairs, and Social welfare, as well as the managing Director of the National Association of Local Authorities (LGDK), and the Managing Director of Danish Regions. It is chaired by the Ministry of Finance and reports to the Danish Government, LGDK and Danish Regions (European Union, 2010).
14. Analysis of contracting local government public services to NGOs, 2009 (only in Estonian), OECD (2010g).
15. These departments are: Regional development; Population facts; Religious affairs; Planning; Local government and regional administration.

16. 95% and 79% of responding countries (countries could respond to more than one mechanism). N = 19 OECD, WP 14.

17. Estonia has 33 "cities" and 193 "rural" municipalities. These designations are historically-based and do not indicate the level of population density, remoteness *versus* closeness to services, etc.

18. The *Local Government Organisation Act* of the Republic of Estonia stipulates local government functions as follows: "1) The functions of a local government include the organisation, in the rural municipality or city, of social assistance and services, welfare services for the elderly, youth work, housing and utilities, the supply of water and sewage, the provision of public services and amenities, waste management, physical planning, public transportation within the rural municipality or city, and the maintenance of rural municipality roads and city streets unless such functions are assigned by law to other persons. 2) The functions of a local government include the organisation, in the rural municipality or city, of the maintenance of pre-school child care institutions, basic schools, secondary schools, hobby schools, libraries, community centres, museums, sports facilities, shelters, care homes, health care institutions and other local agencies if such agencies are in the ownership of the local government. Payment of specified expenses of such agencies from the state budget or other sources may be prescribed by law. 3) In addition to the functions provided for in subsections (1) and (2) [above] of this section, local governments resolve and organise local issues: *i)* which are assigned to them by other Acts; *ii)* which are not assigned by law to other persons for resolution and organisation. Local governments fulfil state functions: *i)* which are assigned to them by law; *ii)* which arise from a contract between an authorised state body and a specific council" (Republic of Estonia, 1993).

19. The average population of municipalities in Estonia is 5 850, but this figure is misleading because of the dominant role played by the City of Tallinn with 407 000 inhabitants, which skews the distribution of municipal populations. In 2010, there were 192 municipalities with a population below 5 850.

Chapter 7

Case Study One: Estonian Education – Sustaining High Quality Schools

Estonia places high societal value on education. Yet, there are concerns that more needs to be done to ensure that its education system sustains high quality and equity, and that what students learn is relevant to the country's evolving social and economic needs. If Estonia is to build upon the existing strengths of its education system, it will need to work as a single government, with greater co-operation among and across levels of government. Central- and local-level policy makers will need a common vision that considers not only the school network and modernising curricula but also national and regional strategic objectives and stakeholder perspectives. Successful education system reform will require greater co-operation among municipalities, and greater cross-sectoral co-ordination and co-operation at the central level. It also calls for the delivery of education to be adapted to the capacity needs of local government and the expressed needs and preferences of local populations.

Introduction

Estonia places a high value on education, as is evident in a number of international measures. Estonian students perform well on international examinations such as the Programme for International Assessment (PISA, OECD) and the Trends in Mathematics and Science Survey (TIMSS, International Association for the Evaluation for Educational Achievement). Estonian students ranked eighth in the 2003 TIMSS (third in Europe). Of the 45 countries participating in the 2009 PISA, Estonian students ranked 8th in scientific literacy, 17th in mathematical literacy, and 13th in reading (OECD, 2010a). Estonia also ranks well on the United Nations Global Human Development Index, placing 25th internationally for levels of educational attainment (Estonian Cooperation Assembly, 2009).

Yet Estonia may need to do more to ensure the high quality and equity of its educational outcomes, and the relevance of the curriculum to evolving social and economic development needs across the country. For example, while the results of the OECD's PISA 2006 showed a relatively high equity of outcomes for students across the country, Russian-speaking students lagged behind (Kitsing, 2008). There is also evidence of educational stratification. While Estonia has a high participation rate in tertiary education, there is also a high drop-out rate (OECD, 2010a; Statistics Estonia, 2010).

The global economic crisis has had a significant impact on Estonia. Resources for education have declined, and are unlikely to increase significantly in the foreseeable future. Schools will therefore be required to make better use of existing resources. There is some evidence that the relatively high number of small schools in Estonia is not optimally adapted to meet the country's demographic and curriculum needs. Policy makers urgently need to ensure the sustainability of the education system, while maintaining and improving outcomes. This is a classic management dilemma – how to do more while facing significant budget constraints – but policy makers are also confronting fundamental questions on governance of the education system. A fragmented system, a shortage of qualified teachers, geographic inequalities, and a historic inability among municipalities to co-operate have undermined the capacity and capability of the education system to continue to deliver high-quality educational outcomes in a sustainable way.

In light of these challenges, Estonia needs to work as a single government, with greater co-operation among and across levels of government, if it is to maintain and build upon the strengths of its education system. Central- and local-level policy makers will need to develop a common vision that considers not only the school network and modernising curricula, but also national and regional strategic objectives and stakeholder perspectives. Ensuring the successful implementation of reform in the education system will also require greater co-operation at the municipal level, and greater cross-sectoral co-ordination and co-operation at the central level. In addition, it calls for the delivery of education to be adapted to the capacity of local governments and the expressed needs and preferences of local populations.

As part of the *OECD Public Governance Review of Estonia,* the Estonian Ministry of Education and Research (MoER) asked that this case study address these specific issues:

- The suitability of the current financing system for supporting general education, and alternative approaches. Is the current finance system (central + municipal funding) the most appropriate approach? In the context of Estonia's decentralised system, does it provide the appropriate incentives and support to achieve effectiveness, efficiency, equity, and transparency?
- The capacity of local governments to provide high-quality education. A related concern in Estonia is whether local governments, particularly in smaller municipalities, have the size and administrative capacity to deliver high-quality education for basic and general upper secondary schools (ISCED 1, 2 and 3).
- Alternatives for strengthening horizontal co-operation across schools and municipalities. Local governments might strengthen capacity and realise efficiencies in delivery of educational services through greater co-operation; however, there are currently few examples of this among municipal governments in Estonia. What are alternatives for strengthening horizontal co-operation?
- Effective re-organisation of basic and general upper secondary schools. What criteria should guide decisions on re-organisation, *i.e.,* how to re-draw catchment areas for schools at different levels? A related topic now under discussion in Estonia is whether to establish nationally administered general upper secondary schools.

The first section of this case study describes some basic facts and figures, the organisation of general education, and the broader economic and social context for education. The subsequent sections delve into the issues and concerns raised by the MoER, putting them in a broader governance context. Each of these sections first describes the issues for readers within and beyond Estonia, and then concludes with observations, noting the implications of current policies and identifying alternative approaches for consideration. The final major section of the report concludes with broad policy principles to guide further decision making for education policy in Estonia.

Background and context

This section introduces the context of the Estonian education system. It describes demographics and the organisation of schooling; presents intergovernmental relationships within and between the national and local levels; and links issues of importance to the education sector to some of the broader governance issues.

Facts and figures: Demographics

The overall population of Estonia is 1.34 million. Although the birth rate is now starting to stabilise, it has declined significantly in recent years; between 1989 and 1998, the birth rate halved. The school-age population was at its highest in 1997-98 at 218 000. By 2006-07, it had declined to about 157 000 students.

Following re-independence in 1991, the number of small community schools rapidly increased – just as the school-age population was declining. Municipalities re-opened schools that had been closed by Soviet educational authorities for economic reasons. By 1998, Estonia had 724 schools. That number has since declined to 559 in 2009-10 (Ministry of Education, 2010; Krull and Trasberg, 2006; Levačic, 2007).[1] Although enrolment is expected to stabilise by 2011, and to start to increase by 2016, both national and local

officials believe that it will be difficult to sustain the current number of small schools across the country.

Over 80% of Estonia's 226 municipalities[2] have populations under 6 000. The majority of Estonian communities, however, are much smaller, with populations of fewer than 3 000. These small municipalities vary significantly in terms of remoteness, density, and other factors. As of January 2011, the population of municipalities ranges from a low of 101 (Piirissaare) to a high of nearly 412 000 (Tallinn). At the same time, about 70% of the population live in the city municipalities; 37% are in the largest urban centres, Tallinn and Tartu.

Estonia is also home to a significant Russian-speaking minority. Over two-thirds (69%) of the population is ethnic Estonian, and 26% are Russian. The majority of the Russian-speaking population immigrated after WWII, although there is also a community of Old Believers who emigrated from Russian Federation in the 17th century. Estonia maintains schools with different language of instruction for such students, which serve 19.5% of the student population (Estonian Education Information System, 2010).

Roles and responsibilities

The *Basic Schools and Upper Secondary Schools Act* (BSUSS) of 1993 is the primary authorising legislation for general education in Estonia. The Act – amended in June 2010 – assigns responsibility for education provision to municipalities. Municipalities own local schools, but must apply to the national government for licenses to establish schools. Municipalities define school catchment areas, *i.e.,* the geographic area which the school serves; a single municipality may have several schools and therefore define several catchment areas. Not all municipalities have schools at every level. While the national government defines the minimum size for which it will provide funding for individual schools, municipalities may also choose to maintain several small schools within close proximity of each other.

There are four types of municipal schools: primary schools (years 1-6),[3] basic schools (years 1-9), full cycle schools (years 1-12) and general upper secondary schools, also referred to as gymnasia (years 10-12). The majority of vocational education and training (VET) schools are owned and operated by the national government.[4] About 30 private schools have been established since 1992.

Schooling is compulsory for students, starting at the age of 7, for years 1-9. Attendance in years 10-12 is optional. Of those students enrolled in ISCED level 3 programmes, 68% attend general upper secondary school (ISCED 3A), and 31.3% attend VET (ISCED 3B) (OECD, 2010a). But there is also a relatively high number of early school leavers. According to Statistics Estonia, in 2009, 13.9% of the population between the ages of 18 and 24 had no more than a lower secondary level education, and are currently not enrolled in a formal education programme (Statistics Estonia, 2010).

Counties have a weak role in regional governance. In education, this role is limited to conducting evaluations of school performance on themes decided by the MoER, and providing advice to municipal governments. Counties also develop plans for educational development, although the scope and impact of these plans is limited. This is in stark contrast to the arrangement prior to re-independence, during which time Estonia followed the Soviet model of strong county-level governments, and weak municipalities. The current governance model reverses this dynamic (Krull and Trasberg, 2006).

Box 7.1. **Roles and responsibilities for education in Estonia**

The responsibilities of the Ministry of Education and Research include: ensuring education laws are observed; elaborating requirements of the national curriculum; establishing rules on national supervision; allocating national funds for education; developing the financial norms for local and school budgets; recognising and licensing educational institutions; providing training for education personnel; and working closely with the Curriculum Development Centre at Tartu University and the National Examination and Qualification Centre. The central government sets minimum salary ranges for teachers at different levels of seniority, taking into account input and advice from the MoER, Ministry of Finance, and Ministry of the Interior.

The responsibilities of education departments within county governments include: executing national supervision of pre-primary and general education schools; formulating county-level plans for education development; disseminating information on public financing; organising cultural and educational events for students and teachers; and advising municipal governments on educational issues.

The responsibilities of municipal governments include: placement of students in pre-primary schools; general education, and schooling for students with special needs; hiring school leaders, providing support for career counselling and school psychological counselling; establishing school supervisory bodies; implementing county plans for educational development; providing support for lunch catering, medical services, and hobby groups. Municipal governments are responsible for all costs of running schools, including maintenance, renovation and construction. The national government provides significant financial support, the majority of which is used to cover salaries for school leaders, teachers and teachers' aides; and ongoing professional development.

School supervisory bodies are responsible for: discussing school development plans; selecting and recruiting candidates for the post of school leader; reviewing the school budget plan and curriculum; participating in teacher recruitment and approving school staff appointments; approving salary rates for the educational personnel as proposed by the school leader; and organising support for schools.

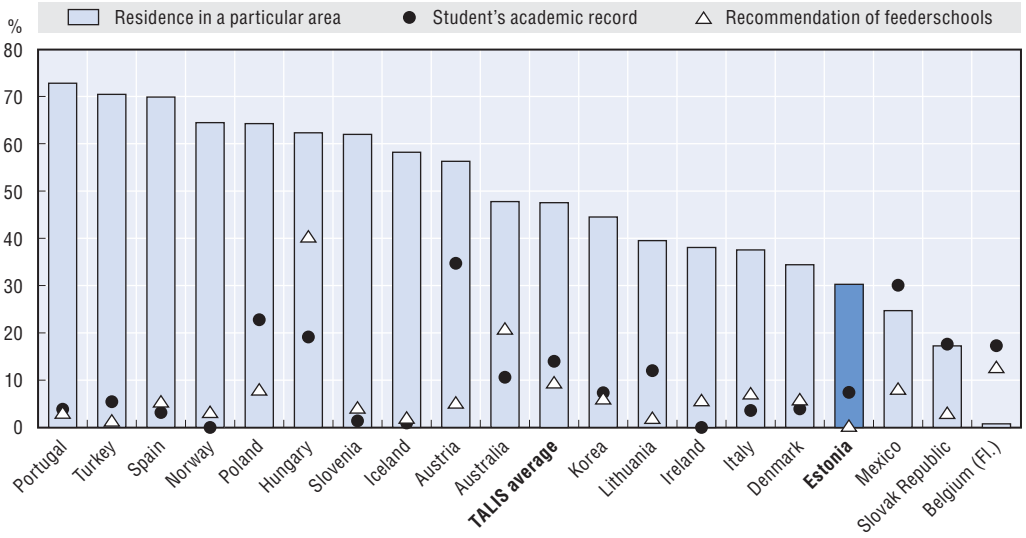
School leaders' responsibilities include: ensuring the effective running and organisation of the school; providing instructional leadership; managing the school's financial activities in co-operation with the supervisory body, the Education Council and the Students Board; signing staff employment contracts; establishing teacher salaries above and beyond the levels set by the MoER, and organising job interviews for vacant teacher posts.

Source: UNESCO, 2006-07, *World Data on Education Country Reports*, 6th Edition.

School competition and choice

As indicated in Figure 7.1, school choice is a very strong characteristic of the Estonian education system as compared to other countries. Parents may choose to send their children to an out-of-catchment-area school if there is a vacancy. Funding follows the student – a system which is intended to encourage competition among schools. Officials believe that schools with more course offerings and higher levels of student achievement will attract more students, and that this competition among schools will provide all schools with incentives to improve performance; or, alternatively, municipalities will have incentives to close or consolidate schools with poorer performance.

Figure 7.1. **Percentage of teachers in schools where the principal reported the following pre-requisites or high priorities for school admittance, 2007-08**



Countries are ranked in descending order of importance attributed by school principals to residence in a particular area.
Source: OECD (2009), *Creating Effective Teaching and Learning Environments: First Results from TALIS*, OECD, Paris.

The MoER has conducted spatial studies as to where students attend school. These studies confirm that students in more populated regions are more likely than their peers in remote rural areas to attend schools outside of their own catchment area. Students in Tallinn and Tartu, and the surrounding municipalities, are more likely to attend schools that are out of their own catchment area; although the majority of students attend schools in their own area, *i.e.,* students from surrounding municipalities may attend schools in the cities of Tallinn and Tartu. Students living in these cities may also choose to attend schools in a different catchment area, but they usually stay within the city boundaries.

Admissions criteria for general upper secondary schools, which are developed jointly by individual schools and the local government, vary. For example, students entering year 10 may be required to take admissions tests. Some schools offer boarding for students from remote areas. Stakeholders interviewed for the case study indicated that school rankings published in newspapers influence parents' and students' choices. However, there have not been any English-language analyses of the impact of this competition on school and student performance in Estonia.[5]

The national curriculum

The national government sets out basic curriculum requirements. The curriculum, which was updated in January 2010, now places a greater focus on integrating elements of the curriculum (for example, across mathematics and science) and ensuring that teaching and learning is relevant to students' daily lives. The knowledge, skills and attitudes emphasised in the new curriculum follow European-level trends in this area. The new curriculum clearly outlines competencies students must achieve by the end of basic school (year 9) and by the end of general upper secondary school (year 12). Students will also have more options from which they may choose,[6] and may earn credits for participation in recreational activities.

Another important change is that the curricula for basic and general upper secondary schools are now in separate documents. Several stakeholders interviewed by the OECD noted the importance of emphasising the distinctiveness of the two levels, particularly for gymnasia (about 225 schools in the overall school network include years 1 to 12). Representatives of the Estonian student union were enthusiastic about the new curriculum. They believe that the separation between secondary levels is important, and that the curriculum in general will be more effective in helping students to develop social, communication and entrepreneurial skills needed in the labour market. Given that the unemployment rate for 15 to 24 year olds is now 23.4% (based on data from the fourth quarter of 2010), these features are particularly relevant.

The new curriculum will be phased in over a period of three years beginning with classes in years 1, 4, 7 and 10 in 2011; adding in years 2, 5, 8 and 11 in 2012 and so on. Students at different educational stages will not face any drastic changes in curriculum requirements. Guidelines for curriculum implementation were scheduled for distribution to schools in autumn 2010. Teachers will receive training to implement the new curriculum. The training will draw on current funds for professional development, as well as European Structural Funds.

According to data from the OECD's Teaching and Learning International Survey (TALIS, 2009b), schools in Estonia have much more autonomy than the average for countries participating in the survey (see Figure 7.2). The new curriculum in Estonia maintains schools' autonomy to develop courses (Estonian Ministry of Education and Research, 2010; OECD, 2009b). For example, a gymnasium visited for this case study has developed options for students at the upper secondary level to study state security, filmmaking, and so on. Even so, the school leader noted that they will likely need to hire new teachers to cover new courses in the updated curriculum.

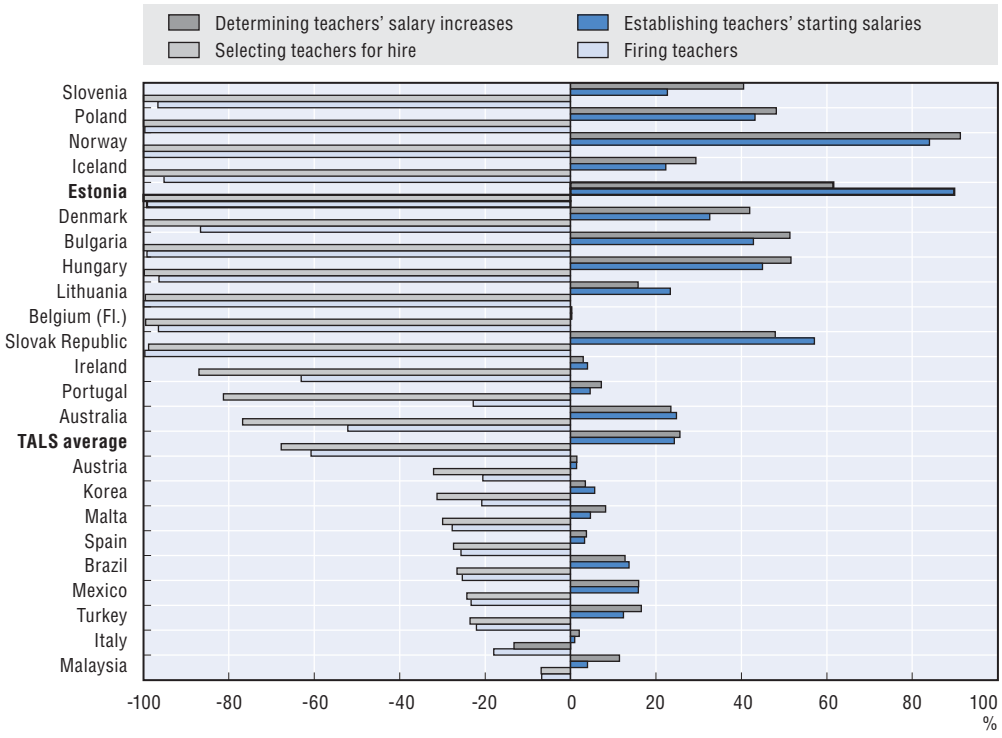
Estonian school leaders also have considerable decision-making authority for determining teachers' salaries and salary increases, allocation of professional development funds, courses offered, and school policies on student discipline and student assessment. School leaders in Estonia have considerable responsibility for hiring and firing teachers as compared to other TALIS countries. However, hiring and firing decisions are somewhat limited by the tight labour market for teachers in Estonia, and the difficulty of attracting and retaining teachers to work at schools in remote areas (OECD, 2009b).

This kind of school autonomy appears to be an important factor in student achievement. According to an OECD (2004a) analysis of the 2000 PISA data, in most countries that have performed well in the PISA programme, local authorities have substantial autonomy to adapt educational content and manage financial and human resources. The OECD analysis also found that in those countries in which school leaders reported a higher degree of curricular autonomy, reading literacy tended to be significantly higher. The OECD cautions that the relationship between autonomy and student performance cannot be interpreted in a causal sense, as other factors may be involved (OECD, 2004a). Nevertheless, these findings have important implications for decisions related to the centralisation and/or further decentralisation of different functions.

Monitoring school and student performance

The government monitors school performance through national assessments and school self-evaluations. Assessments based on a population sample of students in years 3 and 6 are used to monitor how well schools are covering curriculum requirements. Detailed

Figure 7.2. **School autonomy factors, 2007-08**



Countries are ranked in descending order of the percentage of teachers whose principal reported considerable responsibility held at the school for selecting teachers for hire.

Source: OECD (2009), *Creating Effective Teaching and Learning Environments: First Results from TALIS*, OECD, Paris.

results are provided to schools and teacher training institutions, and a summary of the test results is made public. Students in years 9 and 12 take school leaving examinations. The results of the school leaving examinations are also made public and are seen as indicators of school quality. These national assessments will need to be adjusted to reflect the new curriculum goals.

In 2006, Estonia eliminated county-level "complex" inspections. County inspectors now conduct "thematic evaluations" focused on specific areas of concern. The national government also initiated a system of School Self-Evaluation (SSE), which schools are required to conduct once every three years.

Estonia also participates in international assessment programmes, including TIMSS and PISA. While Estonia reports high equity of outcomes for the 2006 PISA across the country, municipalities did not receive individual results for their schools. Municipalities are expecting to receive a breakdown of local results for the 2009 PISA. This will allow municipal and school leaders to compare the performance of their local schools with those in other municipalities/regions within Estonia. They may also identify the relative strengths and weaknesses of their schools.

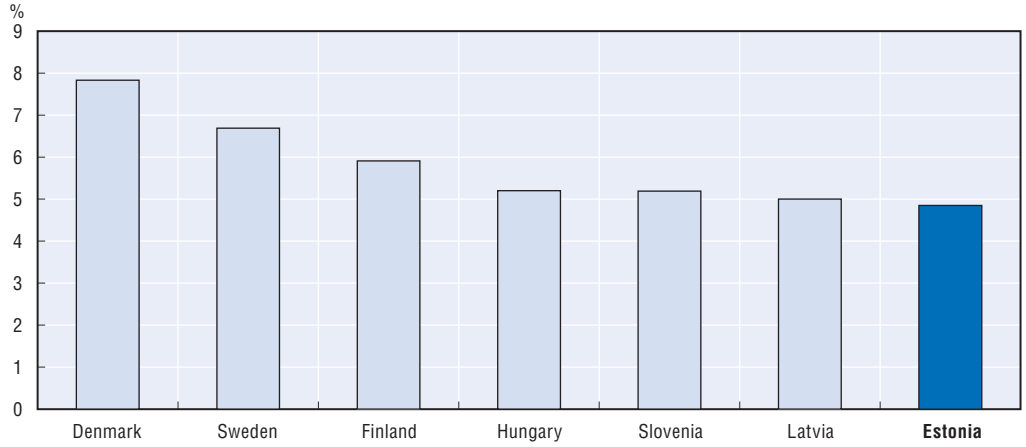
Education funding as a percentage of GDP

Education funding in Estonia has increased at a slower rate than GDP. Between 1996 and 2008, Estonian GDP grew 4.42 times, but funding for general education increased only 3.67 times (Friedrich and Reiljan, 2010). Educational expenditures decreased from 6.05% of GDP in 1996 to 4.85% of GDP in 2007. By contrast, expenditures in other small EU countries

are much higher. In 2007, Denmark allocated 7.83% of GDP to education (although it should be noted that Denmark is among those countries spending the most on education), Sweden 6.69%, Finland 5.91%, Hungary 5.20%, Slovenia 5.19% and Latvia 5% of GDP (Friedrich and Reiljan, 2010, compiled from data in the Eurostat online database) (see Figure 7.3).

Figure 7.3. **Education funding, ISCED 0-6, 2007**

% of GDP



Source: Freidrich, P. and J. Reiljan (2010), *Strategies in the Fiscal Reform of Estonian General Education*, The University of Tartu, FEBA, Tartu; compiled from Eurostat data.

Intergovernmental relationships: Promoting links between education and economic and social development

Intergovernmental relations include both vertical and horizontal relationships. Vertical relationships involve, for example, those between the MoER and local municipalities or county governments. Horizontal relationships include links between and among government units at the same level, for example, at the national level between the MoER and the Ministry of Finance (MoF), the Ministry of Interior, and the Ministry of Social Affairs, or at the sub-national level between municipal governments and between county governments. To a large extent, intergovernmental relationships in Estonian education policy have been limited to vertical relationships between individual ministries and the municipalities.

The MoER has limited tools to influence municipal policy choices. These include financial incentives, legislation, letters, and sharing information and analysis to support local-level decisions. The counties have a very weak role. Horizontally, there are few strong links across municipalities and few horizontal links across ministries at the national level.

The authors of the Estonian Human Development Report (HDR) (Estonian Co-operation Assembly, 2010) suggest that the weak formal horizontal co-operation across ministries – as well as across municipalities and counties – poses a barrier to national and regional social and economic development. They observe that there are no existing efficient mechanisms for the co-ordination of education, economic and labour market policies. The result has been increasing inequality across regions, as economic growth and productivity have been centred in the larger cities of Tallinn and Tartu and their surrounding areas.

The critical question for Estonia, as posed in the 2009 HDR (Estonian Co-operation Assembly, 2010), is whether the current model based on two urban growth centres is suitable for supporting the entire country. The HDR authors note that national policies in

Estonia focus on equalising revenue and social support across the regions. These policies do little to reduce the rate of youth migration to growth centres, where they are better opportunities for education and employment. This pattern will likely contribute to greater economic disparities in the future, and undermine efforts to achieve the government's strategy for a knowledge-based Estonia.

The broader *OECD Public Governance Review of Estonia*, of which this case study is a part, recommends a balanced, strategic approach to social and economic development, with regional policy playing a stronger role (see Chapter 6: "Delivering Public Services Effectively"). However they are defined in the future, regional institutions should take a stronger lead in developing strategies across sectors and linking these to regional development objectives, establishing structures to promote collaboration across municipalities, and ensuring that services are adapted to the needs of the local population. Education would, of course, need to be a key part of regional social and economic development strategies.

The body of this case study describes the MoER's concerns in the current governance environment. The common question across these issues is whether the central government should take a stronger role in managing educational resources or should invest in building municipalities' capacity to improve their management and service delivery ability, and providing incentives for them to do so. The latter strategy – that is, investments in building sub-national capacities – is more consistent with the recommendations of the broader *OECD Public Governance Review of Estonia*.

The final section of the report makes broad recommendations for educational governance and management in Estonia, and is intended to guide decision making at a point where a number of elements are in flux.

The suitability of the current financing system for supporting general education, and alternative approaches

In Estonia's decentralised education system, schools are financed by contributions from national and municipal budgets, as well as additional contributions from state-owned foundations *(e.g.,* foundations administering funds from the EU), donations and school income from extracurricular activities. National and municipal budgets, which comprise the major portion of school funding, are set annually.

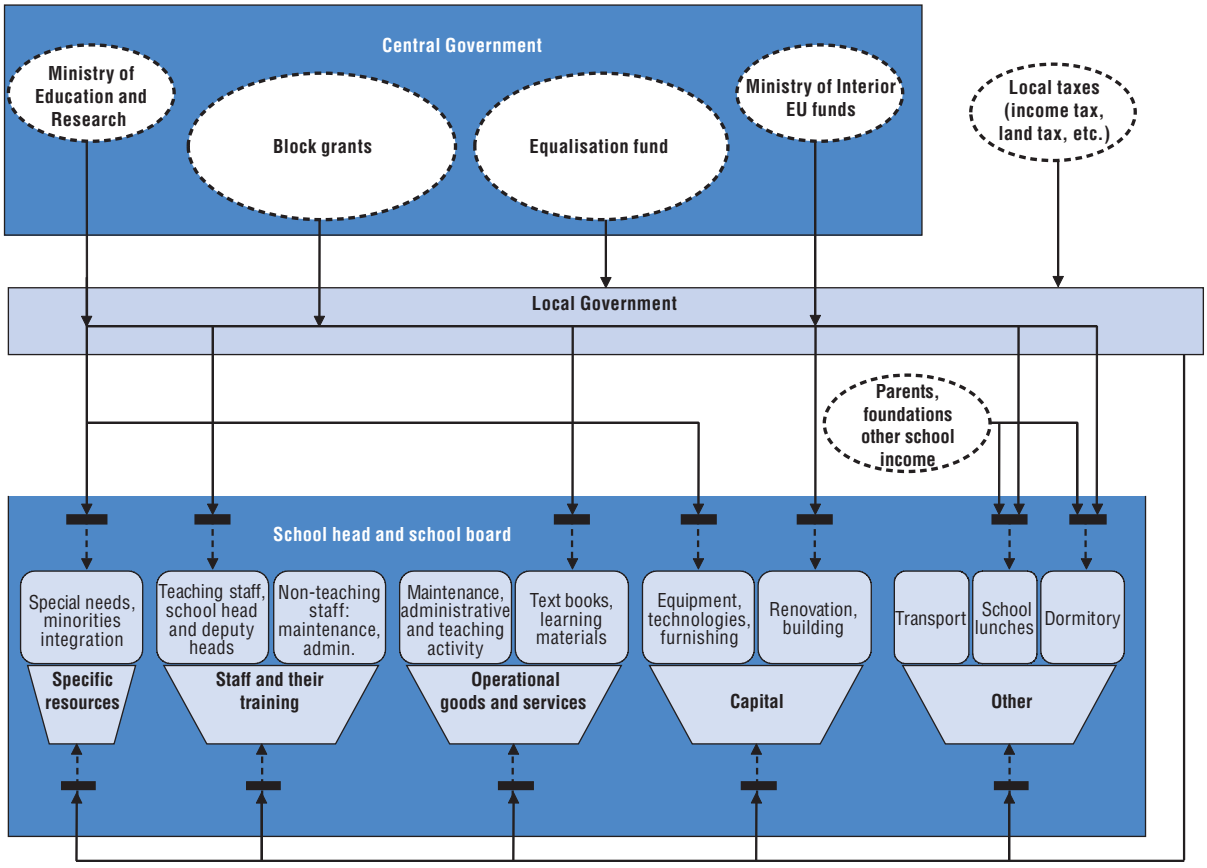
As noted, the MoER has asked whether the current approach to funding (central + municipal funding) is the most appropriate approach. The alternatives would be move to full central management of education funding *(e.g.,* as in France, Greece, Ireland, the French and Flemish-speaking communities of Belgium and for targeted school levels in Lichtenstein, Luxembourg and Austria) or a more fully decentralised system *(e.g.,* Bulgaria, Lithuania, the five Nordic countries, Poland and the United Kingdom). In these countries, funds from central government are allocated to local governments, which take full charge of allocating funding for staff, operational and capital resources for education.

The current national funding formula is described in some detail in the next pages – first to consider the merits of this approach, and second because it plays into other issues being considered in this report *(e.g.,* whether to establish nationally run general upper secondary schools in cases where local governments have requested state support and agree to this arrangement).

The current funding system

Under the current system, education funding is allocated to municipalities as part of a block grant. Figure 7.4 illustrates the funding flows for municipal schools in Estonia. Municipalities decide how to allocate funds to schools within their boundaries. In smaller municipalities, municipal administrators may negotiate budgets with individual schools. The municipalities may decide to re-organise, close or consolidate schools (the national government cannot do this). They may, and often do, supplement teacher salaries (see more detail below).

Figure 7.4. **Funding flows for municipal schools in Estonia**



Funding flows for municipal schools (state schools are funded directly by the central government). Capital resources, including equipment, are provided to schools by local government authorities.

Source: Adapted and updated from original source [Eurydice, (2001), "Diagrams Showing Financial Flows in Compulsory Education in Europe, 2001", *Eurydice*, Brussels.] by Ministry of Education and Research of the Republic of Estonia, (2011).

Thus, the block grant provides some discretion as to how funds are spent. Nevertheless, a number of requirements limit this freedom. Municipalities must provide lunch for all students in basic schools; follow the minimum number of classroom hours prescribed at the national level; ensure that maximum class size does not exceed 24 students at the basic school level (years 1-9) (there is no maximum class size for general upper secondary school); and ensure at least minimum salary ranges for teachers. Municipalities must pay for the operating costs of schools (including salaries of non-teaching staff); purchase furniture, equipment and other teaching materials; and provide support for hobby classes (Levačic, 2007). Only 3% of the national funding allocated for teachers' salaries is designated for professional development.

Municipalities, on average, contribute about 40-50% of funding for general education from their own revenues. Municipal revenues, which are largely based on individual income and land taxes, vary a great deal across municipalities (OECD, 2001a) (see Chapter 6: "Delivering Public Services Effectively"). A 2007 World Bank report analysing Estonia's (then-proposed) education funding formula notes an average local tax revenue per inhabitant of EEK 4 482 in 2005 (about EUR 286), with a maximum of EEK 18 600 (about EUR 1 189) and a minimum of EEK 1 480 (about EUR 95) (Levačic, 2007). Following the global financial and economic crisis of late 2008, however, municipal tax-based revenues have dropped, on average, by 13%; and national grants to municipalities were cut by 11%. The general education grant was cut by 6%. Thus, municipalities have been required to make significant cuts in spending, although municipal cuts to education have been less severe than in other areas (Moisio, 2010b).

The annual envelope for national education funding is co-ordinated each year by the Ministry of Finance (MoF), based on the overall budget priorities and constraints. The central government and the Parliament make final decisions regarding funding levels. However, the MoER, the MoF and the two national municipal associations do engage in negotiations regarding the national education budget. These negotiations help to expose issues that need to be taken into account in the distribution of resources.

The current education formula to allocate national funds to municipal governments was introduced in January 2008. The formula was developed over a period of four years by a special working group (about 30 stakeholders, including representatives from Estonia's two national-level municipalities associations). A draft proposal for the new formula was published and discussed in meetings held around the country (Levačic, 2007), although according to an MoF official involved in the working group, local-level stakeholders did not provide much input.

The motivation for introducing the new formula was to improve the alignment of funding with policy goals. An MoF official commented that the new formula allows them re-allocate funds to better reflect new policy priorities, such as changes in teacher salaries and workload, class size, or new curriculum requirements. The new formula also increases transparency. In the past, for example, the MoF provided funds to municipal governments to help them close funding gaps on an *ad hoc* basis. The national government drew on reserve funds to meet these funding requests. According to the MoF, the new formula appears largely to have succeeded in ending these requests.

According to the MoF, approximately 90% of national funds under this formula are distributed in the same way as in the past. While the current formula represents an important shift from the prior approach in that it has defined a minimum school size, smaller schools may still receive state-granted funds. The prior formula used a strict per capita allocation and thus provided stronger incentives for closure or consolidation of small schools. Between 1998, when the number of schools was its peak, and 2006, the number of schools declined by 139 (from a high of 724 schools in 1998 to 573 schools in 2008) (Levačic, 2007; MoER, 2008).

The 2008 formula is based upon the following factors:

1. The number of students, weighted according to level of education.
2. The number of students with special educational needs.
3. Additional funding for classes with empty spaces (*i.e.,* if the number of students is too low to cover teaching expenses; this applies to stages I to III only, *i.e.,* years 1-9).

4. Regional isolation. This funding is intended to compensate for the difficulty of hiring teachers to work less than full-time, where they do not have the opportunity to supplement hours by working in another school. Schools on small islands are considered regionally isolated, as are schools where the nearest school is a driving distance of 30 kilometres or more away. A school's status is reconsidered every year.[7] This funding ensures that small communities are able to maintain basic schools near families' homes.
5. Language of instruction (Estonian, Estonian language immersion, Russian, English and Finnish). Additional funding is available for municipalities with fewer than 1 000 students – the number of students considered as necessary to run an efficient school network – learning in one of the language groups. Because local governments are small, only four are not eligible to receive additional funding for teaching in Russian, and 10 for teaching in Estonian.
6. A supplement for management (classroom teachers and school leaders). School leaders' salaries are considered as management costs (although school leaders often teach, as well).
7. Schools under united management. For example, schools operating under the same name but functioning separately (in different buildings) can be counted as separate schools upon request of the local government. However, management costs are counted once for these schools.[8]
8. Investment, textbook and workbook, and school lunch components. These amounts are allocated mainly on a per capita basis, but number of classes is also taken into account when distributing the support for investments (Levačic, 2007; Estonia MoF, 2010).

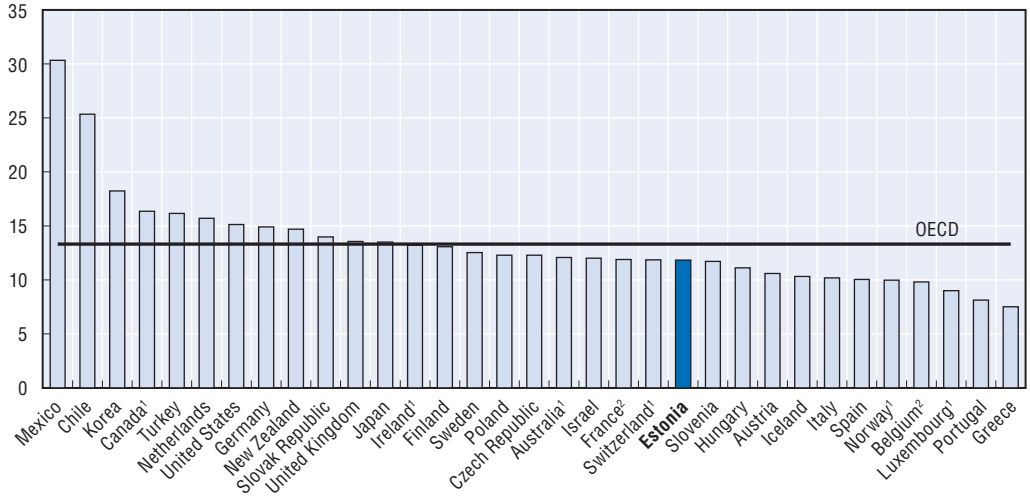
The current formula, which is a combination of per capita and base funding, is essentially an "activity led" model that considers funding needs of schools of different sizes and different grade ranges. For example, municipalities now receive funding for a minimum class size of six students in stages I and II together (*i.e.,* years 1-3 and 4-6), and a minimum of 10 students in stage III (years 7-9). The MoF has calculated that this is the number of students needed for a school to meet expenses. Because per capita funding for classes with fewer than 17 students is insufficient to cover teaching expenses in stages I to III, schools may receive additional funding to cover the empty spaces. To receive additional funding there should be a minimum of six students in a class in stages I and II together, *i.e.,* years 1-3 and 4-6, and a minimum of 10 students in stage III (years 7-9). Classes with special needs students have a minimum of five students. Extra funding is available for schools integrating students with special education needs in regular classes.

At stage IV (years 10-12), however, the minimum class size increases to 21 students (again, the number of students calculated by the MoF as necessary for the school to meet expenses), so there is a stronger incentive for consolidation of schools at this level; municipalities are expected to collaborate in order to rationalise provision at this stage. Moreover, the national curriculum includes a larger number of compulsory courses for stage IV students, so this level is more expensive to operate.

Municipalities may choose to operate schools at any of the stages with fewer students, but must support expenses not covered by the national formula from their own budgets. In larger schools, large classes are funded so that students may be split into smaller sized groups for part of the timetable. At the secondary school level, the student-teacher ratio is close to the OECD average (13 to 1). Other countries with similar ratios are: Australia (12), the Czech Republic (12), Finland (13), France (12), Ireland (13), Israel (12), Japan (14), Poland (12), the Slovak Republic (14), and Slovenia (12) Sweden (13), Switzerland (12) and the United Kingdom (14) (OECD, 2009b) (see Figure 7.5).

Figure 7.5. **Ratio of students to teaching staff in educational institutions, 2007**

By level of education, calculations based on full time equivalents



Secondary education, calculations based on full-time equivalents.

1. Public institutions only (for Australia, at tertiary-type A and advanced research programmes only; for Ireland, at secondary level only; for the Russian Federation, at primary level only).
2. Excludes independent private institutions.

Source: OECD (2009), *Education at a Glance*, OECD, Paris.

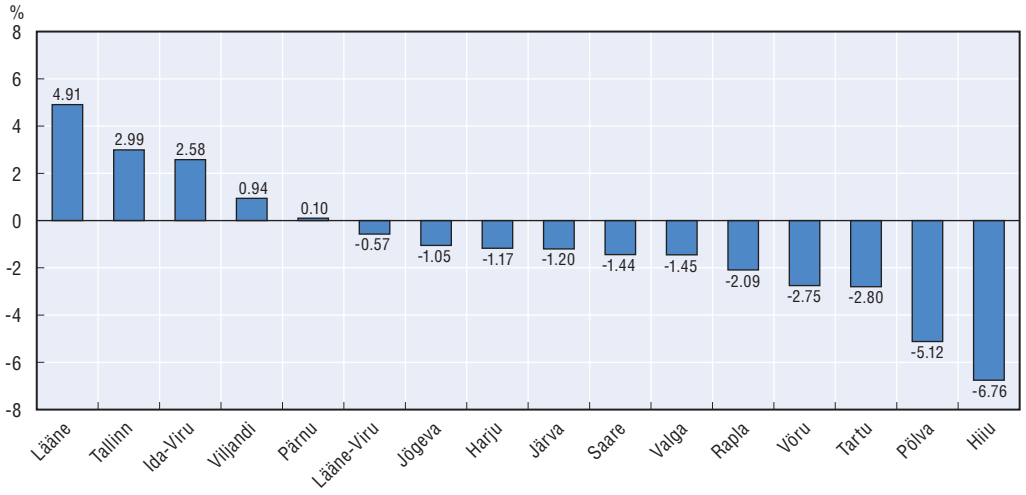
As noted, the recent curriculum also introduces several new requirements which are expected to have a financial impact. While this cost impact was considered and assessed when designing the policy, there was no comprehensive cost analysis – which would have helped provide evidence for decision making. Schools serving students at the upper secondary level will be required to offer options among three broad areas of study (these may vary according to the school's specialty). Local stakeholders interviewed commented that they will need to bring in new teachers in specialty subject areas, develop additional study options for students, plan study trips, etc.

In 2008, five counties received more funding than in the past and ten received less (with a high of +4.91% for Lääne County, and a low of –6.76% for the country island of Hiiu), as illustrated in Figure 7.6. There is an equalisation fund, which allocates additional revenue to all but the richest municipalities (equalising up to 90% of the difference between average per capita tax revenue and calculated expenses). Municipal and national governments negotiate the amount they will receive each year (Levačic, 2007). There is also a reserve fund, which may be used for expenses incurred as a result of staff dismissal, an increase in the number of special education needs (SEN) students, a change in class structure, and increased educational costs.

Municipalities own school buildings and are responsible for renovation and maintenance. While EU funds have been important for supporting a number of projects to renovate school buildings, there are still many schools with outdated facilities and poor learning conditions (Friedrich and Reiljan, 2010). Municipalities face challenges in qualifying for loans for additional infrastructure investments. They may also find it difficult to pay for regular maintenance.

Figure 7.6. **The impact of the new funding model on current educational expenses in the counties of Estonia, compared to the old funding model, 2008**

Figures in percentage



Source: Compiled by Freidrich, P. and J. Reiljan (2010), *Strategies in the Fiscal Reform of Estonian General Education,* The University of Tartu, FEBA, Tartu; compiled from data from Estonia Ministry of Finance 2008.

Teacher salaries

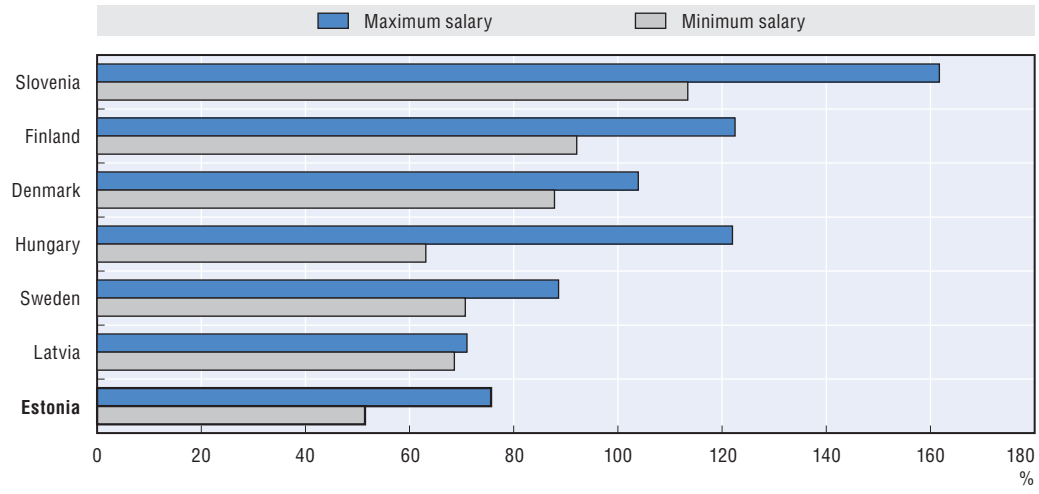
Teacher salaries are a major part of school expenditures. According to the OECD, between 1996 and 2008, teachers' salaries increased in real terms in almost all countries participating in the annual Education at a Glance survey. Estonia was in the group of countries with the largest increases. Even with these increases, Estonia remains in the group of countries paying the lowest rate per teaching hour (at the lower secondary school level) (see Figures 7.7, 7.8 and 7.9) (OECD, 2010a). On a positive note, however, the Estonian Education Personnel Union (EEPU) notes that public school teachers are the only public sector employees in Estonia (at either the national or municipal levels) whose salaries were not cut following the global financial and economic crisis of 2008.

In Estonia, the basic pay levels for teachers at each of the four levels of seniority (junior teacher, teacher, senior teacher, and teacher-methodologist) are determined through negotiations between the national government ministries (including the MoER) and the EEPU (see Box 7.1). The salary structure for teachers is relatively flat. Teachers at the top of this scale earn up to 30% more than teachers at the bottom. This is also true in Denmark (with the exception of upper secondary level), Norway, Slovenia and Turkey. In Estonia, increases in teacher salaries are not necessarily fully matched with increases in allocations to municipal governments, so municipal governments must either cover the additional amount of the salary adjustment or decrease staffing levels. According to municipal stakeholders interviewed, while the national contribution to teachers' salaries has been frozen, the municipalities continue to pay a supplement to the salary level covered by the state grant. This is currently one of the biggest pressures on municipal budgets.

As noted, local governments may choose to supplement the state-financed salary, and many do. In more highly populated regions of the country, for example, municipalities are under pressure to offer salaries and working conditions competitive with neighbouring areas (Monk, 2007). At the same time, remote municipalities are under some pressure to offer additional pay in order to attract qualified teachers who might otherwise not want to

Figure 7.7. **Minimum and maximum basic gross teacher salaries relative to per capita GDP, 2006-07**

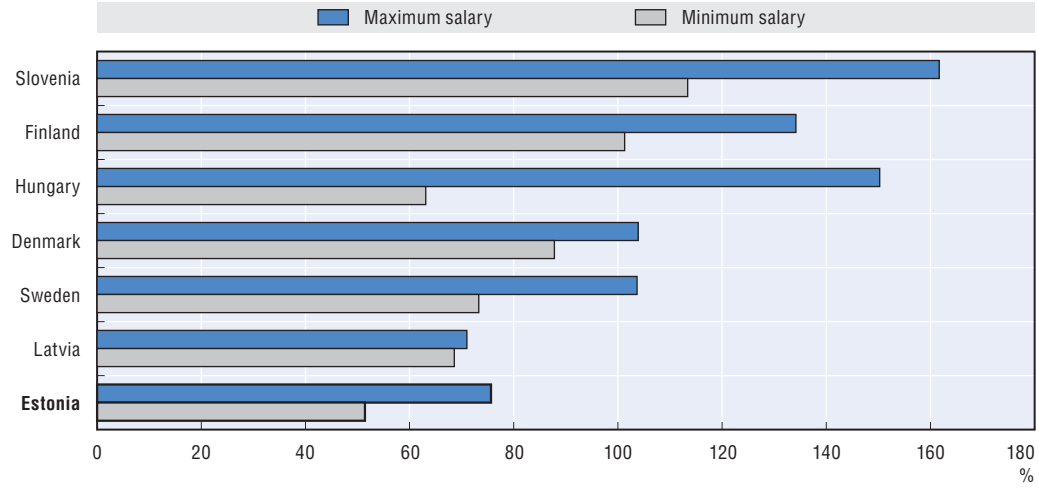
ISCED 1



Source: Eurostat and Eurydice (2009), "Key Data on Education in Europe 2009", Education, Audiovisual and Culture Executive Agency, Brussels, compiled by author.

Figure 7.8. **Minimum and maximum basic gross teacher salaries relative to per capita GDP, 2006-07**

ISCED 2



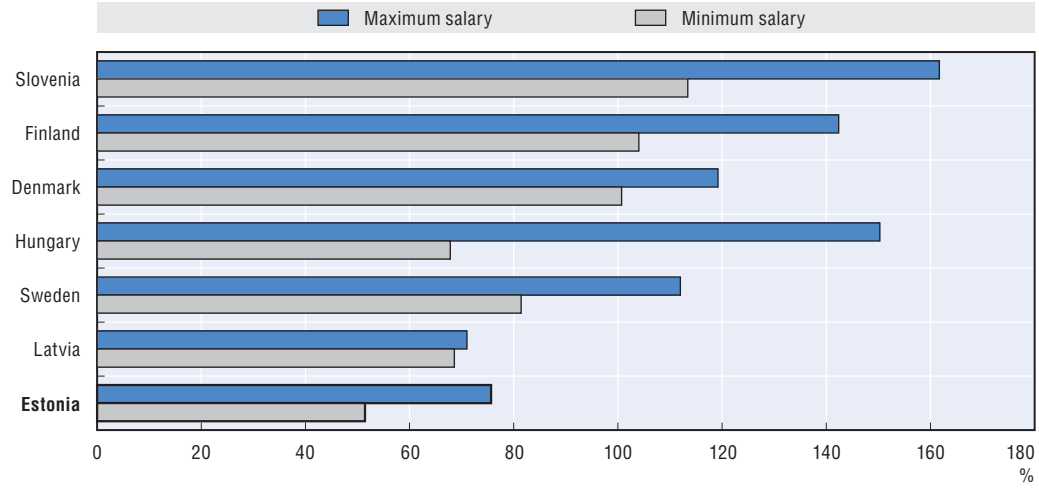
Source: Eurostat and Eurydice (2009), "Key Data on Education in Europe 2009", Education, Audiovisual and Culture Executive Agency, Brussels, compiled by author.

live in rural areas (although, as the case study will show, higher salary alone is not likely a sufficient incentive). Individual schools also have the possibility of offering different rates of pay, for example, to award teachers for individual performance. Local pay levels are agreed upon with the local teacher union representatives. However, municipalities in less-developed regions usually have a lower revenue base, and therefore fewer options for hiring (Friedrich and Reiljan, 2010).

Two-thirds of Estonian teachers and school leaders who responded to OECD's TALIS (2009b) survey said that their school's capacity to provide instruction was blocked "to some

Figure 7.9. **Minimum and maximum gross teacher salaries relative to per capita GDP, 2006-07**

ISCED 3



Source: Eurostat and Eurydice (2009), "Key Data on Education in Europe 2009", Education, Audiovisual and Culture Executive Agency, Brussels, compiled by author.

extent" or "a lot" by a shortage of qualified teachers. As in many OECD countries, the teacher workforce in Estonia is aging. The average age in the profession is now 49. Given this high average age, there are many teachers at the higher end of the pay scale.

At the same time, there are concerns about the need to attract a new generation of teachers. Teaching is not currently a popular choice for young university graduates. While the MoER offers financial incentives for new teachers to work in schools outside the cities of Tallinn and Tartu, few teachers take advantage of this. (According to the MoER the incentive is EEK 200 000, approximately EUR 12 800 at current exchange rates; the incentive does not need to be paid back if the teacher stays for five years or more).

Observations and recommendation on the current funding system

Funding approaches are usually evaluated against the criteria of efficiency, effectiveness, equity and transparency. The current funding formula brings a number of strengths, as well as some shortcomings, in these areas. Alternative approaches and their implications for school funding and management in the Estonian context follow observations on the current funding model.

Efficiency

The choice to support small schools through the current formula lowers efficiency, but reflects a clear political choice to protect small community schools serving students at ISCED level 1. Nevertheless, the pace of school closure has slowed only somewhat compared to the three years immediately prior to implementation of the new formula in the 2008-09 school year. Since 2008-09, a total of 21 schools (all levels) have been closed across the country, as compared to closure of 24 schools between the 2005-06 and 2007-08, and 39 schools between 2002-03 and 2004-05. Even at this pace, many of the national and local policy staff interviewed expressed concern that there are still too many small schools within the system.

There are also many missed opportunities for realising efficiencies through shared services across schools and municipalities. MoER staff members acknowledge that they currently have limited policy levers to influence these local choices, which may ultimately be more effectively addressed through new structures to promote horizontal co-operation, as discussed in a separate section below.

A reported positive result of the current formula is that the MoF has received very few requests for additional funding to cover municipal debt. These requests had been relatively frequent before the new formula was implemented. Municipalities appear to have received the signal that deficits will not automatically be covered by the central government, and that they will need to take greater responsibility for keeping their budgets balanced.

Equity

The 2007 World Bank report evaluated both the vertical and horizontal equity of the (then-proposed) formula. Vertical equity refers to efforts to "level the playing field", so that more funding is allocated to students with greater needs. This includes individual students *(e.g.,* special education students) as well as municipalities *(e.g.,* those with lower tax revenues). Horizontal equity refers to the distribution of expenditure for students deemed to have equivalent needs *(e.g.,* students without special needs). Differences in expenditure that are based on the structural costs of providing an equivalent education *(e.g.,* the higher cost of running smaller schools) are consistent with horizontal equity (Levačic, 2007).

The current formula appears to strengthen the vertical equity of the system. The formula introduces a new weight for students identified as having special educational needs, and provides additional funds for these students. However, the formula does not meet criteria for horizontal equity – that is, local governments are not able to provide an equivalent national standard of education for all students. Although the equalisation fund (which is separate from the actual funding formula) equalises up to 90% of the difference between the average tax revenue and calculated expenditure need, inequities remain. As would be expected given the higher relative cost of running small schools, rural municipalities have higher per student costs, but must allocate municipal funds from a smaller revenue base (Levačic, 2007).

One way to address horizontal inequities would be for the national government to establish more clearly the amount each local government needs to spend in order to achieve a common equivalent national standard. However, this approach would need to be based on good data relating to the structural costs of providing a defined standard of education in different localities *(e.g.,* urban *vs.* rural, remote, etc.). Municipalities would need to track both inputs and outcomes (through improved assessment and evaluation systems). The system currently has only a limited set of tools in place for monitoring performance.

The current formula is also inequitable in that it allows municipalities to support a number of small schools in close proximity to each other, if they choose to do so. These municipalities receive more money from the national government, although they are supporting the same number of students as other municipalities with fewer schools. To address this type of problem, some analysts have argued that education funding formulas should consider population density rather than school size (Gershberg, 2008; Freidrich and Reiljan, 2010). A density adjustment takes into account diseconomies of scale resulting from serving a small number of students in a large geographical area. Schools in rural areas of Canada, the UK, and the US use density (also sometimes referred to as scarcity)

adjustments. However, the distribution of population, conditions for transport, etc., vary a great deal in each of these countries. A density adjustment for the Estonian context would need to be based on good data on the inputs needed for students in different geographical areas to meet national standards.

A separate problem related to equity is that remote municipalities also have considerable difficulty in attracting high-quality teachers. In addition, teachers working in remote rural areas may need specific competencies, such as the ability to teach more than one subject or grade level, to address the needs of students with wide range of learning needs within the same classroom, to be prepared to supervise extracurricular activities, and to adjust to the community (Lemke, 1994; Stone, 1990). Policy makers should consider implementing a survey of Estonian teachers to learn more about how schools in small or remote communities might be made more attractive, and to develop more effective incentives. They should also consider implementing pilots of new incentive programmes. For example, a study on teachers in remote areas of British Columbia, Canada, found that teachers chose to stay in such areas because of the school leader, employment of their spouse in the community, and satisfaction with the rural lifestyle (Murphy and Angelski, 1996/97). This research is vital for better understanding teachers' motivations. Research on why individuals choose to migrate or to remain in small, remote communities may also extend beyond teaching to other professions.

Effectiveness

Across OECD countries, the goal of education funding is to support both access to opportunities and student achievement. Based on the strong performance of Estonian students in the PISA and TIMSS programmes, Estonia is delivering a high-quality education at a low level of expenditure. However, beyond these macro-level data, there is little information on the effectiveness of school-level investments. Ideally, it would also be possible to track detailed information on school expenditures and student outcomes. These data would also support decisions as to how to weight funding allocations for different kinds of students, for example, taking into account socio-demographic background.

These kind of detailed data do not seem to be currently available in Estonia, and indeed are rarely available for most countries' education systems. As a 2001 OECD report on the Estonian fiscal system notes, only a few countries have attempted to use performance- or results-based budgeting to better assess the efficiency and effectiveness of public expenditures. The report notes that these systems are still not well developed: implementation may take several years; administration is complicated; data are usually tracked at a central rather than local level; and it is still difficult to define what levels of spending yield desired outcomes. However, Estonia's MoF is piloting a performance-based budgeting initiative at the national level within the Ministries of Finance, Justice, and Interior (see Chapter 5: "Building a Common Agenda"). If the pilot is successful and the initiative is approved by government, it may serve as a model for other funding areas, including education.

Transparency and accountability

The relative simplicity of the current formula supports transparency. School Boards in each municipality are kept abreast of budget developments, and data are publicly available throughout Estonia. The National Audit Office also monitors municipal financial management. However, as Levačic (2007) notes, the quality of financial control in

municipalities also depends on local probity and competences in this area. This issue thus plays into broader questions regarding uneven management capacity of municipal governments, and alternatives to formula funding (as discussed later in this case study).

Alternatives to the current approach to formula funding

The MoER is interested in learning more about the advantages and disadvantages of concentrating fiscal management at either the national or municipal level, and whether either of these approaches would foster further efficiency and effectiveness while meeting criteria for equity and transparency.

According to Eurydice's (2001) review, Financial Flows in Education in Europe, the majority of European countries mix national- and local-level funding sources (Estonia's current approach). However, in a few countries, a single public authority is responsible for education funding. The central government funds education in the French Community of Belgium, the Flemish Community of Belgium, Greece, Ireland, and Slovak Republic: lower secondary education in Liechtenstein and Luxembourg; and higher general secondary schools in Austria. Decentralisation is quite extensive in Bulgaria, Lithuania, the five Nordic countries, Poland and the United Kingdom. In these countries, funds from the central government are allocated to local governments, which take full charge of funding staff, operational and capital resources. Local governments in these countries contribute revenues from their own tax bases as well, but follow different approaches to allocating funds based on the national funding scheme.

Figures 7.10 and 7.11 show financial flows for education in Greece (more fully centralised) and Denmark (more fully decentralised), respectively. These charts should be considered only as illustrative of alternative approaches to allocation of funding. Other countries following the respective models have adapted them to meet their own needs.

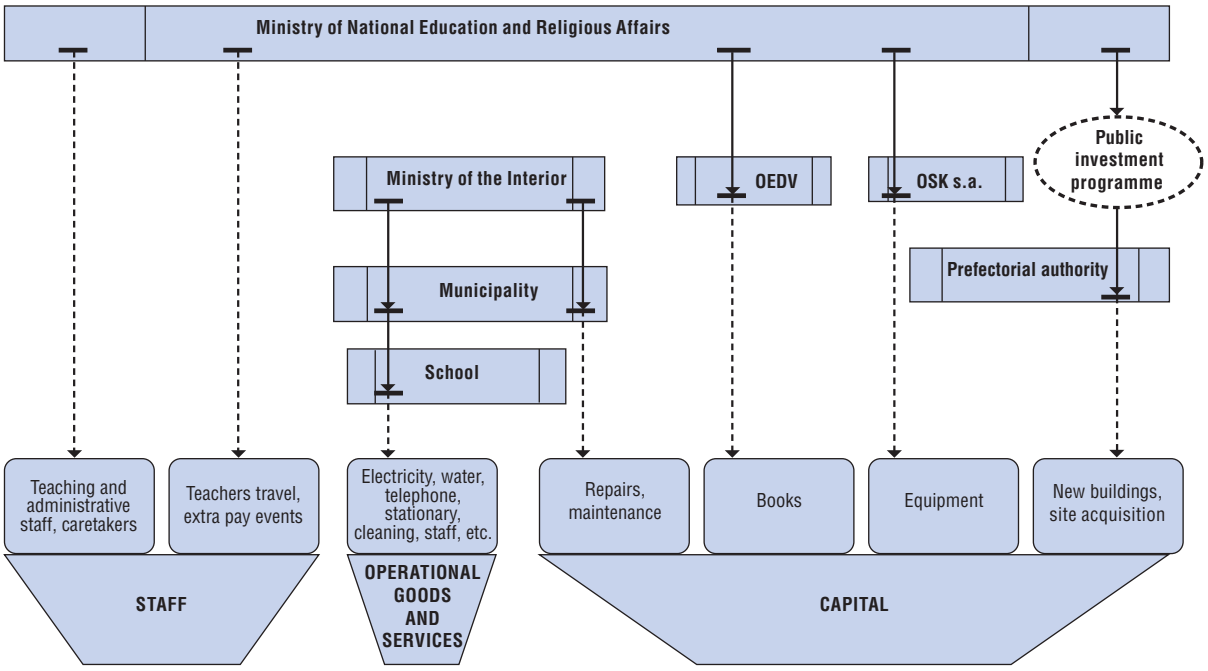
Observations and recommendation on alternatives to the current funding system

A more fully centralised funding system would provide the Estonian national government with greater control over a number of aspects of the system. For example, the MoER would gain more control over decisions related to school consolidation and school closure, although these decisions would inevitably require community engagement. Centralised decision making would also more likely lead to greater efficiencies through central purchasing and capital investments. The MoER may also be able to offer more attractive financial incentives for more experienced teachers to work in remote rural areas (although, as noted, it will be important to gather more information from teachers as to the other factors that influence their decision to stay in rural communities).

A centralised funding system, however, would likely undermine efforts to strengthen links between education and regional social and economic development. At the regional level, there would be much less freedom to shape or adapt education and training programmes to meet development needs identified by local stakeholders, or to incubate new and innovative regional programmes. A centralised funding model may also have a dampening effect on school-level innovation or incentives to allocate resources efficiently within schools (particularly if funds are earmarked for specific programmes and projects). Inevitably, even within a highly centralised system there will be some inefficiencies, as some decisions with financial implications must be made at the school level – such as hiring teachers at different pay grades.

Figure 7.10. **Financial flows in education**

Greece

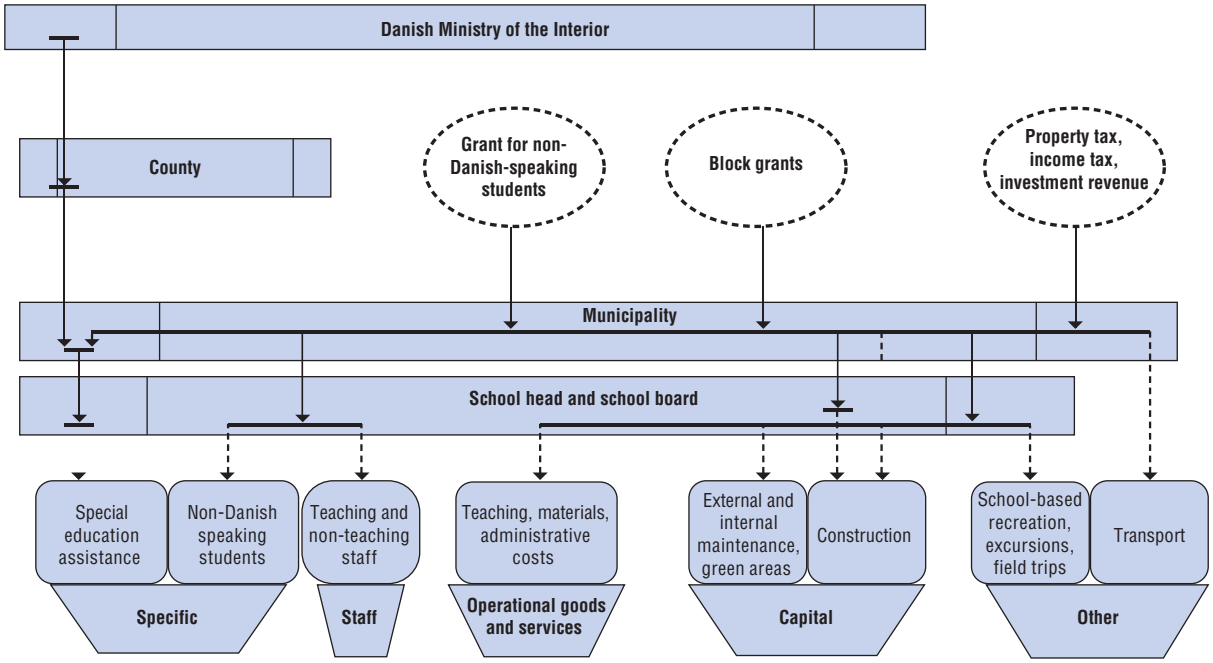


OEDV = Organismos Ekdoseos Didaktikon Vivlion (Organisation for the Publishing of School Books); OSK s.a. = Organismos Skolikon Ktirion société anonyme (Organisation for the Building of Schools, Ltd.); Schools are not allowed to raise money from non-public sources.

Source: Eurydice (2009).

Figure 7.11. **Financial flows in education**

Denmark



"The extent to which budgets are delegated to schools varies from one municipality to the next. The diagram illustrates a situation in which there has been the fullest possible delegation. There is no legislation dealing explicitly with school funding from non-public sources. With the permission of the local authorities, schools may seek non-public funds from sponsoring and donations but this is not common practice."

Source: Eurydice (2009).

Currently, some OECD countries with highly centralised management of educational funding *(e.g.,* France and Greece) also centralise decisions related to personnel, teaching schedules, textbooks used, etc. There is much less emphasis on school autonomy, which is highly valued in Estonia. An OECD (2004a) analysis found that school autonomy is correlated with higher levels of student achievement, as measured by PISA. The relationship between mean performance and the degree of school autonomy in budget allocation is also important, although less pronounced. Essentially, a loss of financial autonomy also leads to a loss of management autonomy. Thus, a centralised system is a less-than-optimal solution for the Estonian context, and should only be considered if alternatives such as increased horizontal co-operation (discussed below) and/or municipal mergers (*i.e.,* building scale) do not succeed in increasing the system's efficiency and effectiveness.

The second alternative is to concentrate fiscal management at the local level, with grant allocations based on population density within municipalities, rather than according to the existing number of schools. This would remove incentives to maintain small schools within close proximity of each other. Moreover, with even greater control over finances, local managers and school leaders may have incentives to seek additional efficiencies, including through collaboration with other municipalities and across schools within their municipality. Local leaders in decentralised funding systems have more freedom to allocate resources where they have identified specific needs, and to initiate innovative projects. They are held accountable for the use of funds, but are empowered to make decisions. Block grants may also help to avoid the "silo"-style services that may be associated with earmarked grants, allowing schools to develop integrated and coherent programmes for students.

There are, of course, some potential negative impacts associated with more fully decentralised block grants, as well. Like the current approach to formula funding in Estonia, much will depend upon the capacity of local fiscal managers to monitor spending, identify areas of need and allocate funding accordingly, seek efficiencies, encourage collaboration, etc. Absent any effort to build local capacity and address barriers to municipal co-operation, a move towards greater local autonomy in spending is unlikely to fix existing problems. National policy makers will also need to strengthen accountability features to ensure that funds are being used appropriately and are supporting desired outcomes.

The third alternative is to maintain the current funding structure, at least over the near term. This option has the advantage of preserving stability within the system. Certainly, the formula might be re-adjusted to address concerns regarding continued inequities across regions (as noted, taking into account issues such as population density, inequities resulting from the current municipal tax structure, the need for more effective incentives for experienced teachers to work in remote areas, etc.). However, the current formula is still very new, and it is difficult to judge its long-term impact and whether and how municipalities will adjust to continued fiscal pressures.

While the second and third alternatives limit the range of financial incentives the national government can use to influence local decision making, efforts might be better focused on promoting greater collaboration across municipalities, and building capacity for more effective and efficient fiscal management. This approach is also consistent with options to expand inter-municipal co-operation in regard to management of education through the establishment of "cluster districts".

Recommendation: The current best option is to retain the existing formula, with some adjustments to improve horizontal equity. Adjustments should take into account municipal population density, inequities in municipal tax revenues, and incentives to attract high-quality teachers to rural and remote regions. In the future, as sub-national governments build capacity, Estonia may consider a more fully decentralised approach to education funding.

No matter which option is chosen, it will be vital to improve mechanisms for monitoring the quality and equity of educational outcomes. Better information is essential for identifying municipalities and schools where student achievement is below national standards. National and sub-national policy makers will only be able to make strategic decisions as to where resources are most needed when they have data (see Chapter 5: "Building a Common Agenda").

The capacity of local governments to provide high quality education

In Estonia's decentralised system, the national government provides the broad direction for educational provision. Its responsibilities include development of standards and curricula, monitoring of school and student performance, allocation of national funds for education, and so on. Municipal responsibilities are determined in the Law on Local Government Arrangement and in other legislation *(e.g.,* the BSUSS Act). Based on current legislation, municipal responsibilities for education include recruitment of qualified teachers, support services for students *(e.g.,* school psychologists, career counsellors, transportation), and support for hobby groups and music education, etc.

At the school level, school leaders, who are appointed by local government, have responsibility for administrative and financial management as well as instructional leadership. School leaders hire teaching and administrative staff, negotiate salary supplements, and are responsible for staff performance appraisal and for the required school self-evaluations (SSEs). Municipalities do not intervene in school management issues, but potentially play a strong role in ensuring the efficiency of local educational provision. Local school boards are also concerned with ensuring the school quality and relevance to local needs. (The roles and responsibilities for educational provision are outlined in more detail in Box 7.1.)

Yet, there is some debate as to whether municipalities – particularly smaller municipalities – have the capacity to carry out these various tasks. All municipalities, regardless of size, must deliver the same services. The size of municipal governments and distance from urban centres will clearly impact their capacity to deliver educational services; for example, their capacity to hire more experienced teachers.

The number of municipal staff working on education in rural areas is usually very small. These staff members may also have responsibility for social services and cultural programmes. Small and remote municipalities also have more difficulty in recruiting and retaining qualified teachers, and may not be able to offer specialised courses *(e.g.,* upper secondary school sciences) or sponsor a broad range of extra-curricular activities. Municipal-level officials interviewed noted that schools in remote areas, particularly at the upper secondary level, might have difficulty meeting some of the new curriculum requirements.

Given the limited possibilities for direct intervention by the national government, it will be important to build capacity for the sub-national level to take on more responsibility. In addition to such policy levers as incentives and regulations, the national-level ministry

should also consider using some of the "softer" tools of governance, such as providing guidelines and sharing models of effective management approaches (Halász, 2004), developing structures for stronger horizontal co-operation, and strengthening attention to monitoring for accountability and improvement.

Horizontal co-operation across schools and municipalities

While horizontal co-operation across schools and municipalities has always been possible on a voluntary basis, the municipal- and county-level officials interviewed noted that, with the exception of some cultural events and shared workshops for teacher professional development, this kind of co-operation rarely occurs. Barriers to wider co-operation across municipalities are sometimes idiosyncratic. In interviews it was indicated that municipalities sometimes have poor relationships with a neighbouring municipality, but good relationships with those with whom they do not share a border. The lack of co-operation may also be due to a lack of experience or models for effective co-operation, fear of job loss within the local community, or fear of a loss of local identity. Competition between schools for students (and the funds that follow them) may also contribute to reluctance of both municipal and school leaders to co-operate.

There appear to be many missed opportunities for greater efficiencies at the regional level, as well as for strengthening effectiveness. Municipalities rarely share administrative services *(e.g.,* joint purchasing), teaching resources *(e.g.,* special courses or distance education), or networks to support teacher professional development. While the county municipal unions might facilitate inter-municipal co-operation for some of these services, as non-profit organisations, their powers are limited; they also generally have relatively small staffs.

Observations and recommendation on horizontal co-operation across schools and municipalities

The *OECD Public Governance Review of Estonia* recommends stronger regional-level co-operation to address current governance challenges (see Chapter 6: "Delivering Public Services Effectively"). In the education sector, the national, county and municipal governments should consider co-operating to create regional "cluster districts" (also sometimes referred to as "collaboratives" or "federations") as a way to encourage more effective and efficient management of education. Typically, cluster districts share services such as school maintenance, transportation, equipment, joint purchasing, etc. They may also negotiate with the national government on behalf of individual municipalities on issues such as capital investments in school facilities.

Cluster districts may also facilitate regional discussion and decision making related to the content and quality of educational offerings. For example, they may help to ensure that general upper secondary schools throughout the district offer a well-rounded range of options for upper-secondary and VET students. They may also foster sharing of teaching resources, such as special courses and teaching materials or distance learning. They may engage in discussions about how to tie education to regional needs for economic and social development. In addition, they may disseminate effective practices and/or organise regional professional development opportunities aligned with the needs of regional schools.

Cluster districts encourage co-operation across communities and schools while maintaining local autonomy. Given the existing barriers to co-operation, the national government should consider providing incentives, facilitating formal agreements between municipalities, and building capacity for co-operative work. Of course, any national efforts

to develop frameworks for sub-national co-operation will need to be developed in partnership with municipalities, counties, the existing county municipal unions and national municipal associations. It should also be noted that the development of collaborative organisations need not be mutually exclusive of decisions to amalgamate municipalities, if Estonia decides to pursue this option. New, larger municipalities would also benefit from participation in regional cluster districts.

There are several models of networks and associations that aim to improve both the efficiency and effectiveness of local governments. Two examples focused on a range of service issues in rural areas are the National Rural Network (NRN) in Italy, and the Rural Policy Programme in Finland. The NRN brings together a range of rural stakeholders in Italy, aiming to develop and strengthen local performance measures for local service delivery (*i.e.*, education as well as other services), identify and disseminate effective practice, and provide training and technical assistance. The Finnish Rural Policy Programme includes a 29-member committee representing nine ministries and 18 organisations. The Committee assists the national government in design and implementation of rural policy, incorporating specific decisions of different governmental organisations. It also issues periodical reports setting out strategic priorities for rural areas, as developed in consultation with rural regions (OECD, 2010i).

There are also networks, or cluster districts, focused specifically on education services. In the US, the majority of states have Educational Service Agencies (ESAs) which assist local schools and districts with cost-saving strategies, teacher recruitment, professional development, school improvement, and so on. The national Association of Educational Service Agencies represents 553 local ESAs in 45 states, bringing together school districts in both urban and rural areas (Association of Educational Service Agencies, 2010). The boundaries for these associations are based on locally determined criteria.

Sederberg (1988) describes a simulation model for establishing "federated school districts" (an alternative term for a cluster district) for rural schools in the American state of Minnesota. The model includes a governing assembly with an executive committee from the existing school boards in the federation, as well as an administrative team representing multiple districts. It also sets a framework for co-operation in planning and implementation of instruction, student support, school facilities maintenance, transportation, administration and other services. The simulation is to be used in the very early stages of planning frameworks for cluster districts.

The National College for Leadership of Schools and Children's Services in the UK provides guidelines and tools on its Internet site. The site sets out a model for co-operation among schools and provides tools to facilitate establishment and management of clusters. For example, the site addresses key issues such as the most effective forms of collaborative leadership, and shares case studies from the project (National College for Leadership of Schools and Children's Services, 2010).

If Estonia chooses to promote the establishment of cluster districts, national and sub-national stakeholders will need to negotiate: the process for establishing districts and the appropriate scale for districts, boundaries and functions. An initial set of criteria for these decisions includes:

- Geographic coherence:
  - borders of municipalities in each cluster district are contiguous, in order to avoid the "Swiss cheese" effect;

  - districts are able to address unique needs of rural/urban communities.
- Economies of scale:
  - districts are large enough to realise economies of scale, but small enough to ensure a focus on local needs.
- Policy coherence:
  - functions are consistent across cluster districts;
  - organisations guide regional economic and community development at the sub-national level, taking into account geographic and functional overlap.

Any legislation outlining the role and functions of cluster districts will also need to address a number of important issues, including:

- Representativeness of the new districts:
  - all member municipalities are represented in the governance structure;
  - schools and parents have the opportunity to provide input.
- Authority:
  - decision-making authority for different levels of government is clarified;
  - functions of cluster districts are aligned with authority and capacity to carry them out.
- Standards and accountability:
  - standards for high-quality service delivery are set at the national level, and districts are held accountable for meeting those standards;
  - inspectorates monitoring district performance are independent;
  - multiple measures are used to track performance to ensure that a full range of performance goals are met;
  - high-performing districts are recognised.

The national government will also need to make decisions as to whether municipalities will be required to join cluster districts or some other form of horizontal network, and whether they will offer municipalities financial incentives for joining (see Chapter 6: "Delivering Public Services Effectively", for a discussion on different approaches to creating new sub-national organisations).

On a separate note, it will also be important for any new structure to take advantage of existing capacities of individual staff members. The OECD met with municipal and county staff members who are experienced educators and administrators, and with creative and entrepreneurial school leaders. Certainly, the individuals interviewed for this case study are by no means a representative sample of the education sector workforce as a whole in Estonia. Nevertheless, it was apparent that while capacity may be low in many parts of the system, there are also a number of individuals whose skills are currently under-utilised.

Recommendation: The current best option to increase the efficiency and effectiveness of municipalities is to enable regional horizontal co-operation through the development of cluster districts or some similar regional structure. Boundaries for new districts should be based on clearly established criteria. New framework legislation and guidelines should outline the rights and responsibilities of national and sub-national actors, and service standards to which the newly established districts will be held accountable. The national government should invest in capacity building to support different stakeholders as they adjust to new ways of doing business.

Performance monitoring to ensure quality and equity of student outcomes, effective resource allocation

A majority of OECD education systems have developed broad frameworks for student assessment and school evaluation. The information gathered is vital for tracking both the equity and quality of student outcomes in decentralised systems. It is also important for identifying strengths, developing appropriate strategies to meet challenges, and supporting more effective allocation of limited resources. As public institutions, schools are also accountable to taxpayers, parents and policy makers, who want to know whether schools are meeting standards. School accountability also serves as a stimulus for improvement.

In Estonia, the MoER gathers information on school and student performance through national tests of student attainment in years 3, 6, 9 and 12, and school self-evaluation (SSE) reports. The MoER also tracks data on teacher qualifications, teacher workload, participation in professional development, support services for students, student migration, student drop-out rates, and so on.

National assessments

National assessments for students in Estonia in years 3 and 6 are intended to provide a snapshot of student performance, and track whether important areas of the national curriculum are being covered in schools. The tests are administered to a sample of students (rather than to all students at these year levels). Some of the subjects covered change each year. The tests typically last approximately 45 minutes. The results for years 3 and 6 are not published, as they are intended only for internal use by schools and the MoER to diagnose needs and develop appropriate strategies. The MoER also shares results with university-based teacher training programmes so that they may take these data into account when they develop their own curricula.

Students in years 9 and 12 take more extensive "exit examinations" (*i.e.,* at the end of basic school and at the end of general upper secondary school), signalling their passage from these programmes. The results of the year 12 graduation examinations are published in national and local newspapers. Parents and students may refer to the results in making decisions as to where they might want to spend their upper secondary years. School leaders also pay attention to these data, and how well they are doing in these unofficial rankings.

School-level evaluations

Each county has an inspectorate, but since 2006, counties no longer conduct in-depth school evaluations. Their role is now limited to thematic evaluations conducted on a sample of 10% of schools, with the themes decided each year by the MoER. County-level inspection staff has also been cut back. For example, Tartu County now has only one full-time inspector.

County education staff interviewed regretted the narrowing of inspection duties. They said that in the past they had a relatively good idea of how well schools in their region were performing, but they are now losing this level of detailed knowledge and familiarity with schools. "Complex supervision", which they had conducted previously, involved fairly lengthy school visits (about two weeks), interviews, document reviews and observation of lessons. At the same time, these county leaders recognised that there were also problems with the former inspection process, and that the MoER had found that it did not motivate improvements in schools.

In 2006, the MoER introduced a school self-evaluation (SSE) system to take the place of the more intensive external school inspection. Schools are now required to create three-year development plans. School self-evaluations, which schools must also conduct once every three years, are based on the targets set out in the plans. The MoER uses SSE reports to identify and share best practices with other schools, but does not attempt to otherwise influence school practices. School leaders interviewed found the SSE process to be worthwhile.

Observations and recommendation on performance monitoring

Multiple measures of school and student performance help to ensure validity and reliability of the data gathered. In Estonia, assessment data provide some insight on school and student performance. However, the current system is too limited to provide the full range of information needed for external accountability, school improvement, and more effective allocation of resources. For example, assessments for younger students can only cover a limited portion of the curriculum – particularly as these tests only last 45 minutes. Exit examinations for basic and upper secondary school provide some insight as to how well students at these levels are performing, but no single test can provide enough information to fully understand their achievement levels.

The SSE are very useful tools, but school leaders and teachers need time to build capacity to implement them, and to develop strategies to address weaknesses they have identified. Moreover, as regional inspectorates' roles have been sharply curtailed, there are now few ways to identify poorly performing schools and inequities within the system. The MoER should consider ways to re-introduce an effective system of external inspection and/or more intensive targeted evaluations of school programmes as a complement to SSE. External evaluation is essential for credibility and objectivity. External evaluators may also bring new perspectives on effective school management and teaching practice, based on their exposure to a wide range of schools. (Grubb, 2000; Nevo, 2001).

It may not be necessary to schedule external inspections of all schools at regular intervals, however. Inspectors or other education officials may identify those schools that appear to be most in need of intervention, and target monitoring and support resources appropriately. In the Netherlands, for example, schools that have been identified as poor quality are inspected sooner and more often than better-performing schools. This approach is referred to as "selective supervision" in the Netherlands (Inspectie van het Onderwijs, 2006).

An additional observation relates to the appraisal of school leaders and teachers. While school leaders appraise teachers and decide upon salary increases, the OECD was not able to assess whether or how well these appraisals align with overall evaluation of school performance and areas where school leaders or teachers may need to strengthen skills. This lack of alignment is a weakness in all OECD countries – and an area where Estonia might pioneer new, effective approaches.

Recommendation: In keeping with broader recommendations for clear accountability in public service, Estonia should strengthen its framework for monitoring school and student performance. This may include more national assessments that cover more aspects of the curriculum (particularly for evaluation of primary school students); re-building an effective external inspections of schools; ensuring that school self-evaluations complement external inspections; and strengthening school leader and teacher appraisals.

Nationally run general upper secondary schools

A question now under consideration in Estonia is whether the national government should run general upper secondary schools, or at least some portion of them. Local governments agreeing to this arrangement negotiate roles and responsibilities regarding school operations with the MoER.

The national government has already begun this process. Between ten and 15 municipalities have requested that the national government consider taking over or initiating a general upper secondary school. Some municipalities may see nationally run upper secondary education as a way to relieve them of the burden of school maintenance. Many school buildings are in bad repair, and local governments do not have sufficient funds to bring them to standard. Currently, there are four nationally-run general upper secondary schools.

Nevertheless, many municipalities resist the idea of nationally-run general upper secondary schools. According to one interviewee, many municipal governments see the proposal for nationally-run upper secondary education as a part of a broader push to re-balance national and municipal powers, and as a potential curb on municipal autonomy. Nor do these municipalities want to cede ownership of school buildings to the national government. The smaller budget allocation for education would also have an impact on municipalities' capacities to qualify for loans. There may also be a number of complications for those municipalities where primary through general upper secondary schools are in shared facilities where administrative oversight overlaps, which is the case in the majority of municipalities (there are 104 municipalities with schools serving students in years 1-12, and 122 municipalities with no separate upper secondary school).

Observations and recommendation on nationally-run general upper secondary schools

Separate, national administration of general upper secondary schools is highly uncommon in OECD countries. Denmark, where both secondary and tertiary education is the responsibility of the national government, is one of the rare exceptions. However, in 2007 Denmark went through a process of structural reform, promoting municipal mergers (now down from 271 to 98) and assigning greater responsibilities to the local level. Denmark devolved responsibility for VET education from the regional to the local level to encourage integration with local economic development (Froy and Giguère, 2010). Municipalities also continue to have some autonomy in regard to the location of secondary schools, the number and size of schools and classes, and the number of classes offered each week at the upper secondary and tertiary levels (Blom-Hansen *et al.*, 2010).

In the 1990s, both Bulgaria and the Czech Republic had decentralised primary through lower secondary education, but administered upper secondary education at the central level. However, in the early 2000s, Bulgaria made the decision to decentralise upper secondary education to the local level as well. In 2005, the Bulgarian National Agency for Vocational Education and Training and the national employment service signed a long-term agreement to establish a unified information system on national, regional and local VET qualifications, and to encourage joint action across levels of government (Froy and Giguère, 2010). In the Czech Republic, upper secondary schools have been decentralised to the regional level, while municipalities are responsible for primary and lower secondary schools (Eurybase, 2007). Finland and Norway follow a model similar to

the Czech Republic: counties or regional authorities are responsible for upper secondary education – both general and vocational (Moisio, 2010b).

Certainly, there are some arguments to be made in regard to the greater capacity of the national government to fund general upper secondary schools (which are more expensive) and to promote high quality, equity and efficiency across regions. Centralisation of schools at this level would also relieve competition between the nationally run VET schools and the locally run general upper secondary schools.

At the same time, general upper secondary schools are an important part of regional social and economic development, as are VET schools. Centralisation of upper secondary education may further weaken links between education and regional development planning. Indeed, if the government chooses to strengthen regional social and economic development, it will be more important to expand sub-national responsibility for both upper secondary and VET education and to strengthen policy integration at this level. This approach is also promoted in the 2010 Human Development Report of the Estonian Cooperation Assembly.

The OECD's Local Economic and Employment Development (LEED) Programme argues that co-operation across local and regional agencies responsible for education, training and regional development is important for preventing duplication, as well as closing gaps in local services. Regional and local agencies are much more likely to develop "big picture" solutions when they work together to address complex problems, and are also much more likely to be successful in the globalised economy (Froy and Giguère, 2010).

A 2010 OECD/LEED review of regional policy integration in different countries finds that regional and local governments need both flexibility and capacity to develop effective policies. In education (general and vocational), flexibility refers to the time it takes to update curricula, adapt training programmes, and manage budgets. VET programmes, in particular, need the flexibility to respond to local business and community needs. In Denmark, for example, training institutions have flexibility to develop programmes responding to the needs of local employers, so long as they comply with the national competency framework and have been authorised by the national Ministry of Education. Flexibility may also refer to students' ability to transfer between academic and vocational tracks (Froy and Giguère, 2010).

At the same time, regional and local stakeholders may also need support from the national level to develop capacity for strategic planning and co-operation. This includes investments in guidelines, training and sharing of best practices. National agencies also need to hold regional and local governments accountable for meeting national goals for education and development.

Recommendation: In order to strengthen links between education and economic and social development, both upper secondary education and VET education should be administered at the sub-national level, and should have sufficient autonomy to tailor provision to local needs. To ensure equity and quality, schools and training centres should continue to be held accountable for meeting national standards.

Re-drawing the boundaries of school catchment areas

The MoER and the Government Office have expressed interest in the possibility of developing quantitative criteria to guide decisions as to how to re-draw school catchment areas. As with many decisions on educational provision, policy makers will need to

consider equity, efficiency and quality. They may look to data on the existing educational situation, disparities in facilities or teacher experience and quality, school performance in national examinations and in external evaluations, costs, and projections of enrolment demand. These decisions will require careful analysis, including data on school performance, spatial mapping, and consideration of costs and benefits associated with different potential boundaries, and preferences of residents in both communities. The MoER has already provided a detailed analysis mapping distances between students' homes, schools, and other services. Local governments may decide whether or not they will follow the MoER recommendations.

Observations and recommendation on school catchment areas

In deciding how to re-draw school catchment areas, two caveats should be noted. First, as is clear throughout this Public Governance Review, Estonia is addressing broader questions related to service provision and municipal sustainability. Decisions as to whether and how to re-draw educational catchment areas should, of course, follow on any decisions to re-draw municipal boundaries, merge services or create service networks. This is particularly important, as any new municipal boundaries would also re-shape the local fiscal environment (see Chapter 6: "Delivering Public Services Effectively").

Second, while the MoER or MoF may suggest options for re-designing school catchment areas, communities are more likely to accept changes if they are not mandated, and if they have a voice in the final decision as to where the catchment boundaries will be drawn. This will be particularly important if new catchment boundaries also involve school closures and consolidations, as such decisions are almost always difficult for communities. Community members justifiably worry that closure of a school will lead to the demise of a community's social and economic vitality. Families that have lived in the same community for more than one generation may feel that important ties with their own history are being cut.

With these caveats in mind, national or regional leaders can facilitate local decision making by providing information and analysis. This may include working with local leaders to set criteria to guide decisions regarding catchment boundaries. National or regional leaders may also provide tools for spatial mapping and consideration of costs and benefits associated with different potential boundaries, and analysis of residents' preferences. If school closures or consolidations are being considered, public debates with parents and community members can help air concerns and also lead to better decision making. Indeed, a number of communities in different countries have developed Internet sites to describe the process for community consultation and decision making regarding school consolidation and school closure. In some cases, community members have set up blogs with online debates regarding the advantages and disadvantages of different options that have been presented to them for the School Board or for public vote (see, for example: *www.vsb.bc.ca/district-news/school-closure-public-consulation-meeting-format* for a public consultation regarding closure of schools in Vancouver, Canada. A community blog on school consolidation in Maine, US presents community members' arguments for and against the issue: *http://futurefreeport.com/2008/11/01/freeport-school-consolidation*).

Communities regularly change school catchment areas, based on a number of pragmatic considerations. These include:

- Minimising walking distances and safety hazards.
- The opening of new school or closing of an existing school.

- New residential areas or decline in population in established communities.
- Diversity of socio-demographic groups included in the catchment area.
- Capacity to accommodate anticipated enrolment.
- Changes in grades configuration model used by the municipality or district.
- Development of new choice programmes or magnet schools.

Several of these criteria are outlined by Grinderud *et al.*, 2009, in a piece on establishment of school catchment areas in Norwegian municipalities.

Mapping tools can facilitate public participation processes and decision making, as described in Box 7.2.

Box 7.2. **School mapping and GIS**

Analytic tools for setting new school catchment areas may involve a combination of school mapping (SM), geographic information systems (GIS) and public participation GIS (PPGIS).

SM, which originated in France in 1963, is now a relatively common approach for education micro-planning in many countries; it is focused on ensuring both equity and efficiency within school catchment areas. The SM methodology typically involves analysis of a range of quantitative factors:

- The existing educational situation, including inequalities, efficiency issues such as drop-out rates, disparities in facilities, teachers, equipment, etc.
- Detailed projections of enrolment demand and definitions of optimal catchment areas for a school.
- Cost estimates (teacher transfers, facilities, equipment and materials).

Since SM is a micro-planning tool, it is usually implemented by administrators at the sub-national level; however, there is also a role for a national education entity (ministry, agency, etc.) in providing data and decision support services.

GIS – which is based on relational database management systems – facilitates spatial analysis, representing schools in their physical, social and geo-political contexts. The tools are flexible and interactive, and thus allow users to consider a range of scenarios and potential impacts – much more easily than would be the case with static maps. GIS tools also enable analysis of more environmental factors than traditional static maps, such as the ability of students to move from one location to another (for example, based on the local transportation network) (Hite, 2008).

In most cases, school catchment areas are decided by local authorities, and are based on trends in student enrolment and analysis of other data on school performance and costs. However, if the definition of new catchment area is likely to lead to school closure or school consolidation, it may be important to include community members in decisions. Hite suggests that the SM and GIS tools may also be used to facilitate public participation in "what-if" analyses and scenario development. Community members are able to better understand the consequences of different scenarios, and may also enrich discussion with a range of viewpoints. Hite suggests that the most successful public processes will outline a clear definition of the issues, the roles of various participants, and goals and intentions for the process.

Source: Hite, S.J. (2008), "School Mapping and GIS in Education Micro-Planning", Working Document, International Institute for Education Planning, UNESCO.

Recommendation: Decisions regarding boundaries for school catchment areas are best made at the municipal level. The MoER should provide information and analysis and help to establish criteria to guide decisions.

Recommendations for sustaining high-quality education in Estonia

A number of governance-related issues are currently under discussion in Estonia, and decisions related to educational governance need to be part of this broader context. For example, any decisions related to public financing and tax reform will also have an impact on education funding, and the MoER should be part of these as well as other discussions related to broader governance reforms. The national government's strategy for national and regional social and economic development will also have an impact on how the MoER approaches the question of whether to establish nationally run general upper secondary schools.

Taking these uncertainties into account, and based on the discussion of the current system, and the alternative approaches and examples above, the following four broad recommendations are offered.

Recommendation 1: Link education to broader goals for social and economic development through strong horizontal and vertical relationships

Whether Estonia chooses to support a model with economic growth centred in the larger cities, or with growth distributed across regions, education needs to be a key part of the strategy. Stronger horizontal relationships at every level of government will be important to developing linked strategies for high-quality education promoting equitable outcomes, and economic and social development.

Currently there are few formal horizontal links across the ministries responsible for setting the overall direction of education, social and economic policies, and even fewer links across municipalities and regions. But decisions related to education funding structures, as well as governance of general upper secondary schools and VET cannot be made independently of these broader strategies. Ministry-level decisions, at a minimum, need to be aligned. Ideally, decisions at this level will reinforce and support each other. Should Estonia decide to support greater regional development (with many centres), inter-ministerial co-ordination will also be essential for setting up new frameworks and structures, developing supporting legislation and regulations, deciding upon the functions that should be delegated to the county and municipal levels, and clarifying rights and responsibilities at the different levels of government.

Vertical relationships are also vital to strengthening links between education, and social and economic development. National policies that are developed with the participation and input of sub-national stakeholders will better reflect local needs and preferences for development. Sub-national input on the development of policy will ensure that policies respond to local needs and concerns.

Recommendation 2: Establish new structures to promote regional collaboration

As discussed, co-operation across municipalities and regions is currently voluntary and *ad hoc*. Formal structures, such as cluster districts to support services like joint purchasing and professional development networks, can help to systematise co-operation and address some of the existing barriers. They can also reinforce links across education and stakeholder groups engaged in regional economic and social development.

The national government will have key role to play in developing supporting legislation and regulations to create new structures. At the same time, it will be important to engage regional and municipal stakeholders in the design of new cluster districts or other frameworks for collaboration. Local stakeholders will also have a better view of their constituents' needs and priorities; moreover, their buy-in will be essential to the success of any new structures. Vertical and horizontal co-operation in these first stages of designing new structures will set the foundation for ongoing co-operation.

Recommendation 3: Build capacity and monitor performance at all levels

Decentralisation has introduced greater complexity to government at all levels. It will be important to continue "capacity-building" across national ministries and across regional and local governments. Capacity-building is a "soft" tool of governance, as compared to the "hard" tools of financial incentives and regulations. New capacities can include skills related to policy development, improving communication and consultation processes (both vertical and horizontal), and engagement with community members, for example in decisions related to school closure and consolidation. Softer approaches, such as identifying and disseminating models of effective practices, are often more successful than mandating specific approaches.

A well-structured system of performance monitoring is also essential for ensuring the quality and equity of student outcomes, for learning about what policies are working well and where improvements are needed, and for making better decisions regarding allocation of limited resources. Municipal and school leaders will need skills to interpret performance data and to develop appropriate strategies to address needs.

Recommendation 4: Exchange knowledge with peer countries

As a new member of the EU, and even more recently the OECD, Estonia will have more opportunities to exchange knowledge and share experiences with a wide range of peer countries. These international forums allow exploration of education issues and policy options beyond those already being discussed in national debates in Estonia. In turn, other countries are likely to be interested in understanding factors behind the success of Estonian students on international assessments such as PISA and TIMSS.

The most effective strategy may be to look to different countries or groups of countries for different issue areas. As noted above, Estonia may explore a range of options for funding education by exploring very different examples of centralised education funding in France and Greece, or models for decentralised funding in the Nordic countries. In regard to issues related to rural education, Estonia may look to experiences of a wide range of countries. For example, while general education policies in large countries such as Canada and the US are not as clearly relevant to the Estonian context, very small rural communities confront very similar issues. Estonia may refer to ways in which rural communities in these and other countries have engaged community members in decisions regarding school closure and consolidation.

As noted, the Nordic countries have also developed new models for assessment and evaluation of student and school performance that may be useful for Estonia. While the education system in the Netherlands is very different from the Estonian system, its approaches to combining external school inspections and internal school self-evaluation may nevertheless be relevant.

The Central and Eastern European Countries (CEECs) also have much to learn from each other. While there are important differences between these countries, they nevertheless face a number of similar challenges in their transition to democracy, new forms of governance, and new approaches to planning for social and economic development.

While countries do tend to adopt general trends in educational policy making, each country also adapts and changes policies to fit its own context. New and innovative policy approaches to education often emerge from this process. Continued participation in international assessments such as PISA and TIMSS, and in-depth comparative studies focused on specific policy issues, will also be important. These international comparative studies can help identify what works in different contexts, and point to new directions for policy development.

Conclusions

The questions explored in this case study with respect to financial sustainability, service quality, local capacity and horizontal co-operation are not new to Estonia. While the school-age population may reach a low point in the coming years, and then start climbing again, this does not present a sufficiently strong argument to maintain the *status quo* until "times are better." In order to capitalise on the strengths of its education system, and overcome the challenges being presented by demographic shifts and resource constraints, the need to successfully address the most difficult questions has become urgent.

A whole-of-government approach. In light of the division of responsibilities and funding structures that surround the provision of education, the relationship between Estonia's central government and its local authorities is closely linked. Yet, change in the education system has been slow overall, and sometimes stalled. This may be due at least in part to a tension between central "authority" and local "autonomy", expressed through centrally established policy objectives (the "what") and sub-national level policy implementation (the "how"). Within its sphere of influence, the MoER will need to build its stewardship capacity, *i.e.,* its ability to supervise and manage all the elements relating to the education system placed in its care, including education policy priorities, the programmes designed to realise these priorities and the actors at all levels of government who implement them. This is particularly critical given limited possibilities for direct intervention in how local governments provide education.

As explored in Chapter 4: "Promoting a Whole of Government Approach", the role of the steward is not to direct or control, but rather to guide and co-ordinate. Accomplishing this in the realm of education will require stronger guidance and improved co-ordination on the part of the MoER, increased attention to external accountability, and greater sub-national capacity to use the resources (such as the data and analysis) housed within the ministry.

Working as a single government entails co-ordination not only at and by the Centre-of-Government, but also among line ministries in the realisation of objectives that have cross-sectoral links. For example, there is a need for strong collaboration and co-ordination between the MoER and the Ministry of Interior/Regional and Local Affairs if cluster districts are to be established. This need for co-ordination also extends to ensuring that the education priorities and outcomes are aligned to the longer-term national growth objectives – *i.e.,* are students learning today what they need to apply in the future to maintain and increase Estonia's competitiveness.

As the pivotal central-level actor in education, the MoER has a strong interest in ensuring that there is sufficient capacity at the national and sub-national levels to realise education policy and programme priorities. Reinforcing the "soft" tools of governance will be necessary, and is in line with a stewardship role. Such tools include providing guidelines, sharing effective management approaches, strengthening attention to monitoring for accountability and performance improvement, and building – in collaboration with sub-national actors – frameworks that promote horizontal co-operation, and supporting these with positive and clear incentives.

Building a common agenda. Central- and local-level policy makers will need to develop a common vision for how education is provided, working towards a shared outcome. This requires an ability to understand and balance government values, societal preferences, current and future costs and benefits, and expert knowledge and analysis. Estonia has clear values with respect to education, which it seeks to maintain. These include providing high-quality education; maintaining school choice; and ensuring that young children (years 1-9) have easy access to schools regardless of where they live. In addition, personal attachment to *alma mater* runs high as multiple generations have often attended the same school. Increasingly, these values need to be balanced with the realities of demographic change and resource constraints. Balancing these forces to develop a common agenda for education becomes crucial, and requires data and analysis, as well as the capacity to use the information.

Despite the extensive data collection undertaken by the MoER, evidence in policy making appears under-utilised. Greater use of evidence could help the MoER and local authorities evaluate policy options and make informed choices regarding such crucial matters as the school network, the cost of implementing curricula changes, and addressing horizontal inequities that arise from the current funding system. In the case of the latter, for example, good data relating to the structural costs of providing a defined standard of education in different localities could help the central government establish more clearly the amount each local government needs to spend in order to achieve such common equivalent national standards.

As part of exercising its stewardship role, the MoER should look at how it can better use its central policy, research, co-ordination and monitoring roles to consult and dialogue with all stakeholders in order to develop a vision and consensus to get around the current implementation impasse.

Delivering public service effectively. Estonia has placed a clear priority on education, evident in its funding allocations, particularly at the local level. As is the case with public service delivery overall in Estonia, education faces a municipal capacity challenge brought on by scale. In order to further build and sustainably maintain the high-quality education Estonians expect for their children, local authorities will need to build their capacity and willingness to co-operate with one another. While there is much that can be done based on local initiative alone – *e.g.,* a handful of municipalities sharing administrative services and/or teaching resources, or establishing networks that support teacher professional development – greater support from the central level will be necessary given that inter-municipal co-operation in Estonia is not systematic.

As noted in Chapter 6: "Delivering Public Services Effectively", voluntary co-operation in Estonia is unlikely go much farther without direct guidance or financial incentives from the central government, including the possibility of a central-level decision as to which

services should be undertaken co-operatively. Ensuring greater horizontal co-operation in education will require a more structured approach, and this study explores cluster districts as an option. Here, the central level plays a key role in promoting regional-level co-operation and establishing the corresponding frameworks and incentives to build scale, coherence, and more effective and efficient management of education. Meanwhile, the local level can continue to provide the level of education demanded, and maintain its autonomy in how education policy is implemented. A sustainable result, however, will of course also require vertical co-ordination among national and sub-national stakeholders, both government and non-government *(e.g.,* citizens, businesses, teachers, etc.).

This case study has aimed to respond to issues confronting the MoER from both an education and broader public governance perspective. While a specific policy area, education provides the opportunity to highlight how working towards a single government approach is applicable at a sectoral level. The study makes a clear argument for building horizontal co-operation at the local level as a means to strengthen the capacity of local governments to provide high-quality education, and sheds light onto what will be required to achieve this. It also provides insight into how national and sub-national interests can align, making room for a larger central role while still remaining respectful of local autonomy. This study has illustrated the tight links between sectoral policy and the need for a broader public governance perspective in order to ensure a high-quality education system, equity of outcomes, and a citizenry that is prepared to build and meet the economic and socio-economic future that Estonia seeks.

Notes

1. There is a three-year transition period for the new compensation scheme, so while the number of schools declined from 579 in 2006 to 559 in 2009-10, the MoER notes that the new formula is has not been fully implemented and these closures do not reflect new incentives of the formula.
2. Estonia has 33 cities and 193 rural municipalities. These designations are historically based and do not indicate the level of population density, remoteness *versus* closeness to services, etc.
3. Students leaving primary school will transfer either to a basic school or to a full cycle school after year 6.
4. The cities of Tallinn and Tartu and the municipality of Vaike-Maarja each own and administer a VET school at the municipal level.
5. The international research on the impact of school choice on school and student performance has yielded mixed results. A recent review of research on school choice in the US (Miron *et al.*, 2008), examined evidence from 87 studies. They found that some studies suggest positive impacts, and others indicate negative impacts. There is a need, they conclude, to better understand the factors that lead to success within particular schools or groups of schools.
6. Upper secondary schools must offer at least three study options from which students may choose (in addition to compulsory courses). Each broad study area must include courses from two subject domains. At least one area must include a science-related subject, and another must include a social science. Course content is not limited.
7. Currently, there are only four island schools and one mainland school meeting the criteria for regional isolation.
8. Currently, only three small schools operate under terms of united management.

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Chapter 8

Case Study Two: Social Services for the Elderly in Estonia

OECD countries are rapidly ageing, and Estonia is not an exception. Estonia's elderly are one of the poorest and most vulnerable segments of the population, as health and social care expenditures are lower and reported health problems among the aged higher than in other European countries. In light of increasing needs, poor health and social outcomes for the elderly, and limited financial means to reinforce inputs, Estonia needs to change the way in which it delivers care to the elderly population, in particular by working as a single government – across levels of government, among municipalities and care providers, and across sectors – in order to reduce the fragmentation of resources, capacity, and knowledge about elderly needs. Such a joined-up approach is necessary to find a sustainable response to Estonian social, cultural and economic circumstances and to meet the goal of equality of access to services for all citizens across the country.

Introduction

Populations are aging rapidly in Estonia and across Europe, but elderly Estonians seem to be one of the poorest and most vulnerable segments of the population, in striking contrast to other European countries. The statistical portrait of Estonia brings out a picture of a country with lower health and social care expenditure, and an elderly population reporting more health problems than its peers in neighbouring European countries. Estonia's old age pension rate is relatively low, and figures signal a growing rate of old age poverty. While Estonia is still catching up with other OECD countries in Europe in terms of GDP per capita, the level of care provided is not simply a budgetary issue; the way services are currently delivered also seems to lead to sub-optimal results and may involve hidden costs.

In light of increasing needs, poor health and social outcomes for the elderly, and limited financial means to reinforce inputs, Estonia needs to change the way in which it delivers care to the elderly population, in particular by working as a single government – across levels of government, among municipalities and care providers, and across sectors – in order to reduce the fragmentation of resources, capacity, and knowledge about elderly needs. Such a joined-up approach is necessary to find a sustainable response to Estonian social, cultural and economic circumstances and to meet the goal of equality of access to services for all citizens across the country.

A whole-of-government approach. Improving the sustainability and quality of elderly social care begins by improving knowledge about user needs and how to meet them. The Estonian social care system for the elderly is provider- rather than user-driven. Local governments respond to service demands with imperfect information and without a quality framework, so service provision is more likely to reflect their own interests and needs rather than the actual service needs of the local population. Different needs assessment practices and procedures apply; therefore, the range, level and quality of services and care – as well as the level of users' co-payments – differ from one local government to another. In the absence of nationally standardised needs assessment, benchmarking and comparison across local governments are impossible, and users lack the information to make choices based on quality as well as price. In order to encourage innovation and to promote market mechanisms for increased efficiency and effectiveness, the State and sub-national governments need to work together to remove information asymmetries and to prepare a level playing field for improved service delivery.

A common agenda. A more user-focused approach will also require different sectors, such as the health and social care systems to work together more closely based on a common knowledge and understanding of elderly needs. A national dialogue on Estonia's aspirations for the level of care its elderly should receive could help establish a common agenda for various sectors and stakeholders and provide a basis for improved cross-sector co-operation. While Estonia currently has limited resources for elderly care, developing a vision for where it wants to go as the country and its population become richer will help set a path for developing service standards and expectations in line with standards of living,

on the one hand, and building up the capacities and capabilities needed to deliver these services, on the other. This would also be assisted by developing research and training based on the specific needs of the elderly.

Delivering public services. Currently, provision of social care services to the elderly in Estonia depends largely on the financial capacity of local governments, as distinct from the central government. But there is more involved in local governments' responsibilities than just financial capacity. Local governments are responsible for ensuring that the elderly have access to services needed to cope with their daily lives, including access to social services, emergency social assistance and other social assistance. This does not mean that local governments should provide all the services themselves. Whether appropriate services are provided by local governments, other public foundations or private providers is a matter for local governments to decide and arrange. Therefore, the responsibility to respond to established service needs requires not only financial capacity, but also organisational, administrative and professional capabilities.

Standards and procedures – as well as the overall capacity and resources to respond to service needs – differ greatly across local governments, primarily due to differences in territorial and population size, and demographic structure. Improving inter-municipal co-operation will depend on eliminating barriers and disincentives using existing resources more effectively – for example, to respond to growing geographic inequality of access to services for the elderly and lack of access to appropriate levels of care. The level of users' co-payments for certain social services keeps rising, which may begin to limit access to existing services, *i.e.,* making access to care dependent on users' financial ability to pay. The current financing scheme of care services is not sustainable in the long term and does not ensure access to services based on forecasted needs. For the system to be sustainable, the financing scheme needs to be reformed and the stream of funds diversified so as to make financing less dependent on the financial resources of local governments and users' financial ability to pay.

The aim of this case study is to bring out a picture of the elderly population in Estonia and the services that it receives, and to compare this against relevant international experience in order to facilitate policy decisions about how to organise the financing, regulation and provision of social services for the elderly for a more sustainable and co-ordinated delivery of services. The analysis focuses on international and national figures on demographic structures, health status, service expenditure, service provision, use of services and old age pension. For analytic purposes, and in order to assist comparison and forecasting of future service needs and demand, the focus of the case study is on the 65+ population in both the international and national data. From figures compiled specifically for this case study at the Social Policy Information and Analysis Department at the Ministry of Social Affairs in Estonia, the categories "Social welfare institutions for the elderly" and "Other social protection of the elderly" form the basis of the analysis.

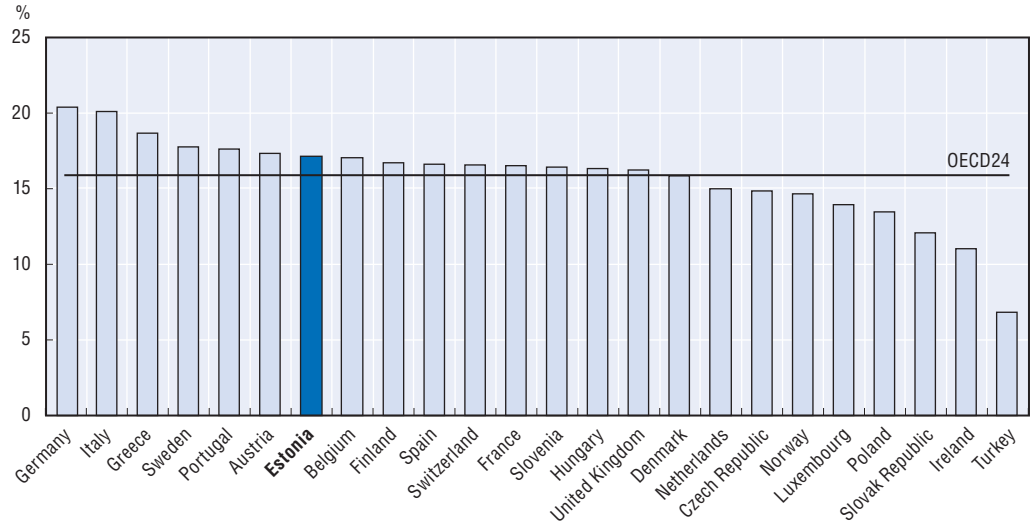
This case study acknowledges that policies designed to meet the service needs of the elderly include services for elderly disabled persons, whether disability existed prior to retirement age or developed in old age. Where and how the needs of elderly disabled people are met depends on the type and level of disability identified in a more sophisticated needs assessment exercise. Finally, the analysis focuses on social services and how the financing and provision of social services intersect with the financing and provision of healthcare services at the level of the community and institutional care services. An analysis of the healthcare system as a system of care for the elderly is beyond the scope of this study.

It is, however, crucial to recognise that in order to meet the needs of a rapidly ageing population, health and social care needs should be assessed and considered in a comprehensive fashion and a more holistic policy response designed accordingly. This recognition has major policy implications. The analysis in this case study shows that it takes more than just social services reform to ensure better service delivery to the elderly in Estonia. The analysis concludes that a systemic approach is needed, and that it is beyond the scope and control of local governments alone to change the system. The state has to intervene, and thus the central government has to take responsibility for bringing together the various stakeholders in a search for the right way forward for Estonia as a whole.

The Estonian context

Shrinking size and a rapidly ageing population are the two major demographic trends in Estonia since the 1990s. The size of the Estonian population has fallen by 3.8% since 1998. Life expectancy at birth for both men and women, on the other hand, has been rising over the past decade and the mortality rate of 65+ for both men and women has dropped, increasing their percentage of the overall population (see Figure 8.1).

Figure 8.1. **Proportion of population aged 65 and over in selected OECD European countries, 2009**

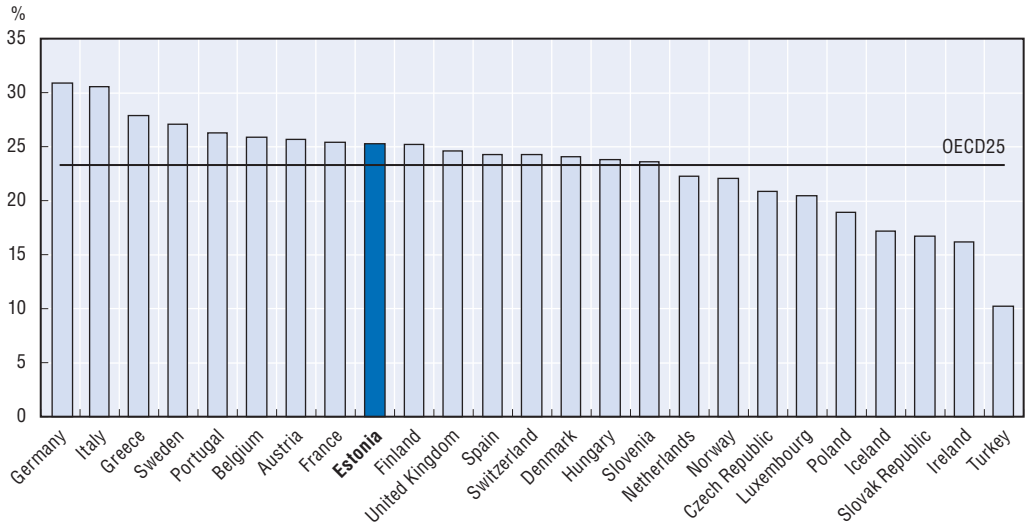


Source: Eurostat Databases (2010).

As a result, the old-age dependency ratio (population over 65 years relative to population between 15 and 64) has risen in Estonia from 22.4 to 25.3 during 2000-08. In this respect, Estonia is rapidly coming to resemble other OECD European countries in terms of its ageing population. Its old-age ratio is similar to neighbouring Finland, as well as larger countries such as France and Spain. In comparison, the average old-age dependency ratio for 25 OECD European countries is 23.2 (see Figure 8.2).

One of the key implications of a rising old-age dependency ratio is a diminishing tax base due to the decreasing size of the working population. While the infant mortality rate in Estonia has been dropping fast, from 8.4 to 5.0 during 2000-08, the fertility rate has been rising from 1.4 to 1.7 over the same period. When these trends come together, *i.e.*, the rise in number of children and the rise in the number of older people, it results in a rising

Figure 8.2. **Old-age dependency ratio in selected OECD European countries, 2009**



Source: Eurostat Databases (2010).

overall dependency ratio. That means that an increasingly smaller Estonian working population has to support a rapidly growing population at each end of the life cycle, *i.e.,* both their young children and a generation of elderly Estonians that is living longer than ever. As a result, the Estonian situation is particularly problematic.

Longer life expectancy also means rising number of people living longer with chronic conditions, including multiple chronic diseases *i.e.,* living with two or more different diseases, which is medically a more complex condition, and socially, a more fragile and risky condition. Apart from an overall falling mortality rate, there has been a significant drop in the rates of death due to diseases of the circulatory system and a growing number of people aged 65 and older living longer under chronic condition due to health problems caused by diabetes, coronary heart diseases, cancer and high blood pressure (OECD, 2010e).

When compared with other neighbouring and northern European countries, there are some indications that the existing level of care to the Estonian elderly population is not delivering optimal results. Measures on health outcomes[1] (OECD, 2010e) rank Estonia near the bottom, together with Hungary, Poland, the Slovak Republic and Turkey (see Tables 8.1 and 8.2). Estonia also stands out in terms of the number of older people reporting long-standing illness or health problems, or self-perceived limitations in daily activities. The provision and level of social care is only one factor – and probably not the most important one – affecting health outcomes in old age; it is dependent on a number of factors such as previous health behaviour and access to healthcare. However, poor health outcomes are an influential factor in determining the level of needs and demand for care services in old age.

Since the 1990s, many OECD European countries have been faced with the question of how to meet the needs of a growing number of people who require long-term health and social care. Estonia is now also facing this same challenge, but as a relatively poor country with very limited means (in contrast to better-off European countries). Despite strong economic growth over the past 15 years, compared to other OECD European countries, Estonia remains the 5th poorest country in GDP per capita terms (OECD, 2010e),[2] with only the Slovak Republic, Hungary, Poland and Turkey being poorer. Estonian is also spending less on healthcare than

Table 8.1. **Retired people with long-standing illness or health problem, 2004-08**

Retired people aged 65-74, 75-84 and 85+, with long-standing illness or health problems (%)

	2004			2005			2007			2008		
	65-74	75-84	85+	65-74	75-84	85+	65-74	75-84	85+	65-74	75-84	85+
Denmark	29.9	38.1	47.6	35.2	40.7	38	37.1	42.4	35.4	31.2	40.7	41.2
Estonia	80.8	79.2	81.2	75.4	85.1	81.7	80.2	84.9	87.8	78.5	86.7	90.2
Ireland	45.9	55.7	57.8	49.2	53.9	49.1	54.8	56.7	65.6	51.4	58.1	69.2
Latvia	. .	. .		64.8	73.7	66.9	67.7	78.3	79.5	66.3	77.8	78.3
Lithuania	. .	. .		58.1	71.4	75.1	64.4	78.7	81.5	62.8	75.4	72.8
Poland	. .	. .		68.8	74.2	75.7	69.4	76.3	78.9	66.6	76.3	82.8
Finland	69.5	80.9	80.6	74.3	82.5	83.7	68.9	80.7	88.1	65.0	75.2	84.3
Sweden	71.2	80.5	83.7	64.0	70.5	80.7	49.8	55.2	61.6	50.6	52.1	59.7
Iceland	58.5	42.8	45.6	59.2	36.4	50.3	35.8	24.0	19.3	57.2	42.2	44.8
Norway	49.9	52.1	53.9	47.1	51.8	46.4	48.5	52.0	58	38.7	49.4	45.5

Source: Eurostat Databases (2010).

Table 8.2. **Self perceived limitations in daily activities among retired people, 2004-08**

Retired people aged 65-74, 74-85 and 85+ reporting that they have been severely hampered for at least the past 6 months (%)

	2004			2005			2007			2008		
	65-74	75-84	85+	65-74	75-84	85+	65-74	75-84	85+	65-74	75-84	85+
Denmark	. .	. .	. .	. .	. .	. .	. .	. .	. .	7.7	10.6	13.1
Estonia	34.3	48.0	62.9	33.7	51.2	69.0	22.4	38.3	58.9	27.4	40.8	51.1
Ireland	10.2	18.2	24.5	11.5	21.7	21.5	10.3	19.1	32.3	8.9	16.9	22.2
Latvia	. .	. .	. .	26.6	36.8	47.1	22.3	31.9	39.8	18.1	27.9	41.1
Lithuania	. .	. .	. .	24.1	44.6	61.9	23.5	36.3	52.7	18.0	31.1	41.7
Poland	. .	. .	. .	6.0	9.6	13.2	16.8	28.2	44.7	15.2	25.1	40.6
Finland	19.8	32.7	35.5	21.6	34.8	40.2	14.2	27.3	38.7	11.7	24.3	38.5
Sweden	16.4	28.9	38.5	15.0	24.6	40.8	9.3	14.8	21.8	11.4	14.0	25.3
Iceland	23.4	27.1	30.2	20.2	19.3	33.9	11.6	6.3	15.8	23.6	20.4	25.9
Norway	13.8	18.1	23.8	12.3	16.5	21.4	14.6	12.9	28.2	9.0	14.2	14.9

Source: Eurostat Databases (2010).

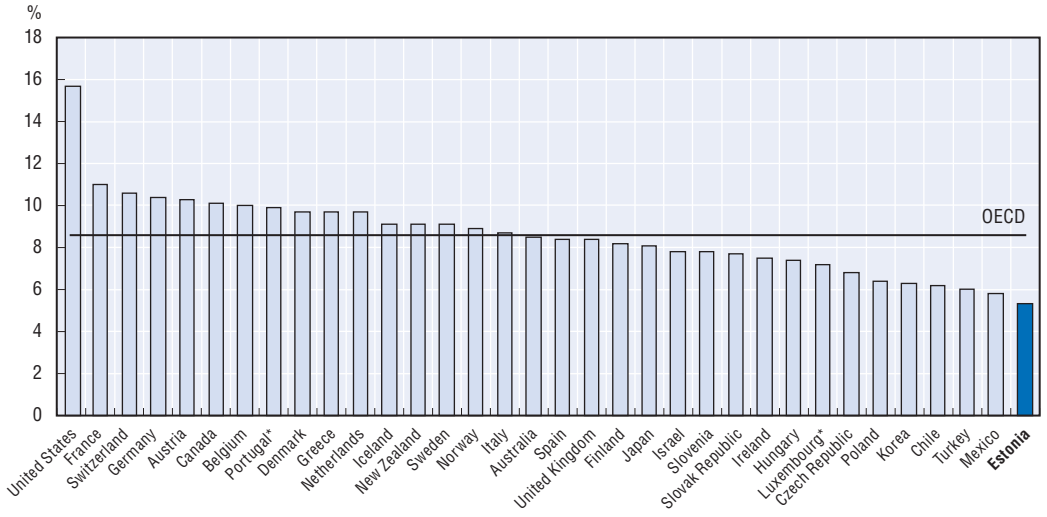
any of the OECD countries, measured in both percentages of GDP and per capita spending (OECD, 2010e)[3] (see Figure 8.3). Comparing social protection and the level of social care across these same countries brings out much the same picture, or even worse (Eurostat, 2010).[4] In terms of the level of cash benefits or benefits in kind, Estonia most resembles other eastern European countries: Latvia, Lithuania, Poland, Hungary and Slovak Republic.

In general, rising healthcare expenditure is associated with an ageing population, advancement of healthcare technology and rising public demand. Although the association between total healthcare expenditure and population aged 65 years and over is much more complex, this comparison puts the size of the healthcare system in Estonia, in terms of level of expenditure and care, into a wider European context.

The number of long-term care beds in hospitals is relatively high in Estonia (see Figure 8.4), but healthcare expenditure on long-term nursing care, measured in purchasing power standard per inhabitant, is low compared to these eastern and central European countries (Eurostat, 2010).

There are two main sources for financing healthcare in Estonia: the Estonian Health Insurance Fund, and private household out-of-pocket payments. Both measured in percentages of GDP when compared with a number of countries (see Figure 8.5), and

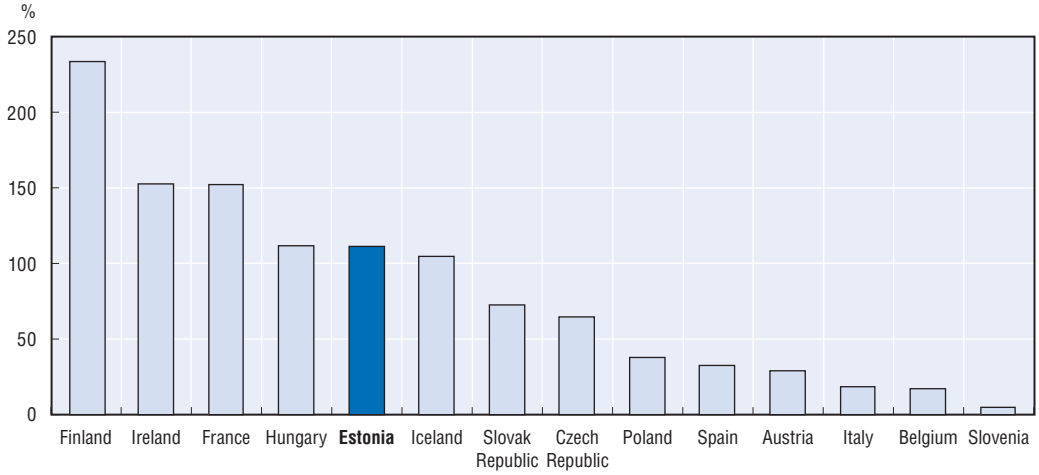
Figure 8.3. **Total expenditure on health as a % of GDP, 2007**



* 2006.

Source: OECD (2010), *Health Data*, OECD, Paris.

Figure 8.4. **Number of long-term care beds in hospitals, 2008**



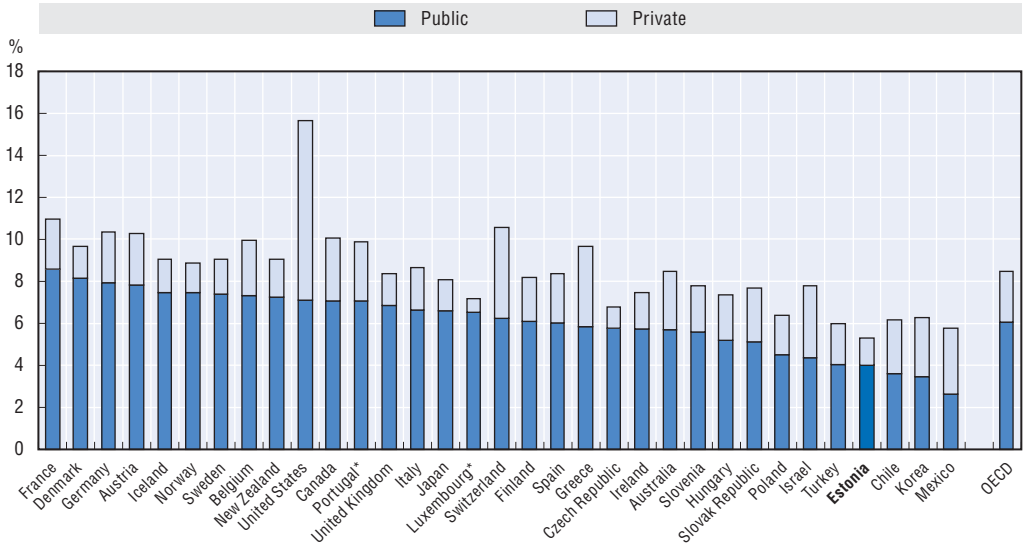
Source: Eurostat Databases (2010).

measured in purchasing power standards per inhabitant, when compared with neighbouring eastern, central and northern European countries (see Figure 8.6), Estonians' out-of-pocket payments for healthcare are relatively low.

However, the Estonians see themselves as a Nordic country, and in terms of social welfare policy, the Nordic or the Scandinavian model seems to be the point of reference in terms of possible policy directions for the Estonian ageing population. If so, Estonia still has a long way to go. With one of the lowest GDP per capita in Europe, retired Estonians receive very low levels of old age pension (see Figure 8.7). This is a matter of concern if out-of-pocket payments or users' co-payments are to be one of two or three (or more) main sources of financing long-term health and social care services, moving into the future.

Figure 8.5. **Public and private expenditure on healthcare, 2007**

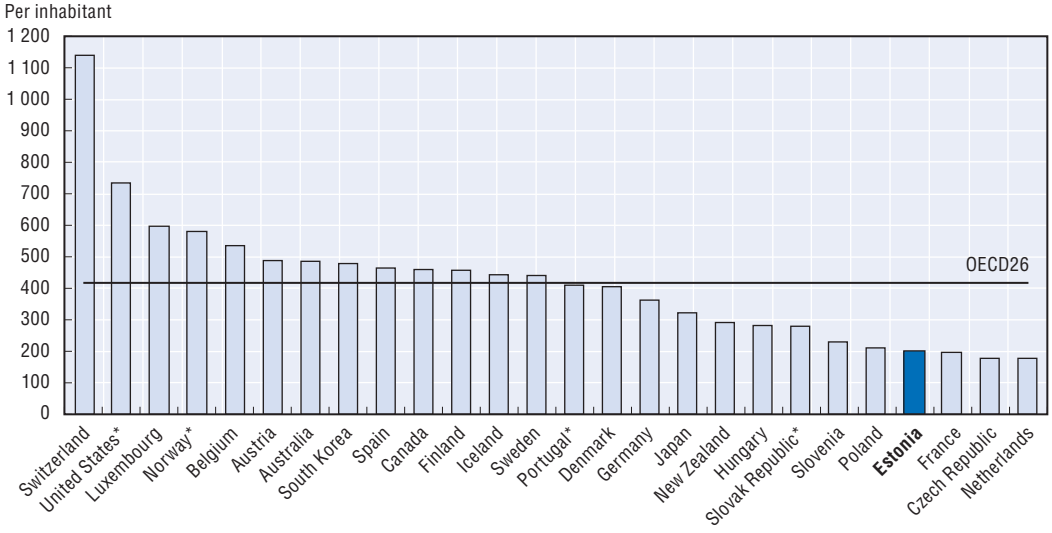
As a % of GDP



Source: OECD (2010), *Health Data*, OECD, Paris.

Figure 8.6. **Private household out-of-pocket expenditure on healthcare in selected OECD countries, 2007**

Measured in purchasing power standard



* 2006.

Source: *Eurostat Databases* (2010).

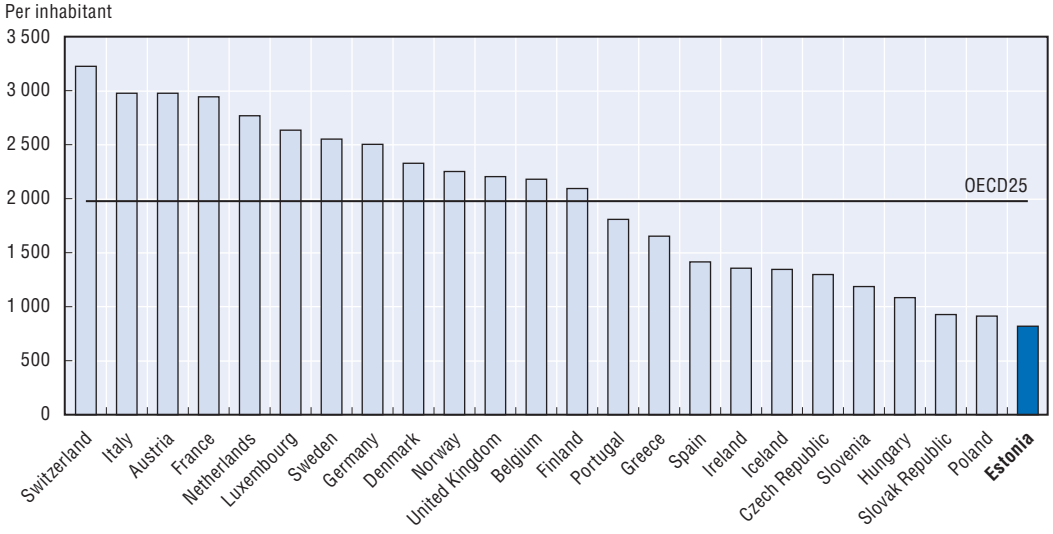
For that reason, the fact that the rate of poverty among older Estonians has been rising (though with recent improvements) is a concern (see Figure 8.8[5]); this may put further constraints on the ability to plan health and social care services by means of increased co-payments or users charges.

Cross-county comparison of services

The demographic profile of the Estonian ageing population – *i.e.*, whether the elderly are living in cities or rural municipalities – and the highly autonomous nature of local

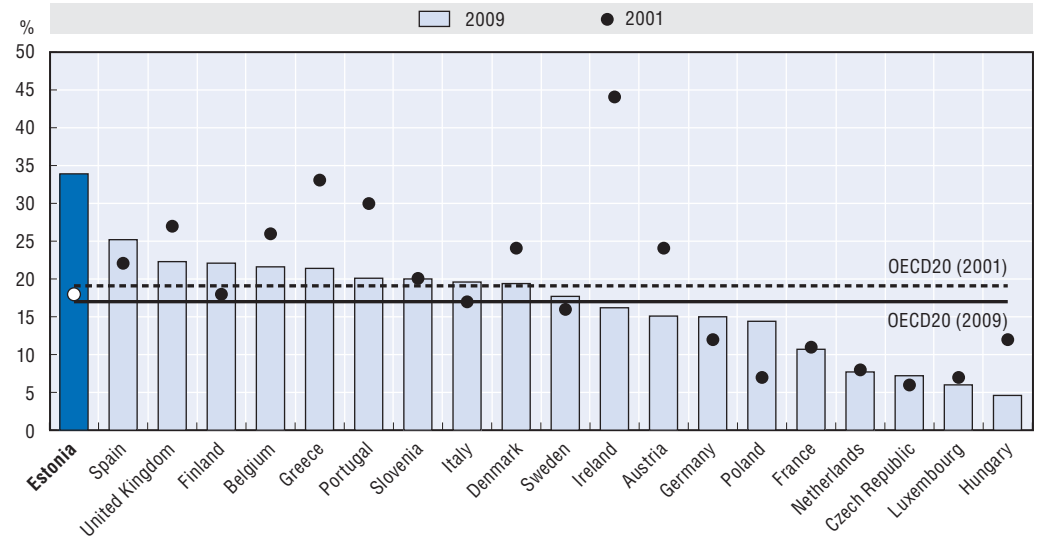
Figure 8.7. **Old age pension per inhabitant in selected OECD European countries, 2007**

Measured in purchasing power standard



Source: Eurostat Databases (2010).

Figure 8.8. **At-risk-of-poverty rate of older people (65+) in selected OECD European countries, 2001 and 2009**



Cut-off point: 60% of median equivalent income after social transfers.

Source: Eurostat Databases (2010).

government, are features which may make it more problematic for Estonia to develop an appropriate level of quality services and to maximise the use of overall limited resources. The willingness to think, co-operate and plan across geographic and administrative borders at local levels – in co-ordination with state policy – will determine its success. Here the responsibility lies with local politicians.

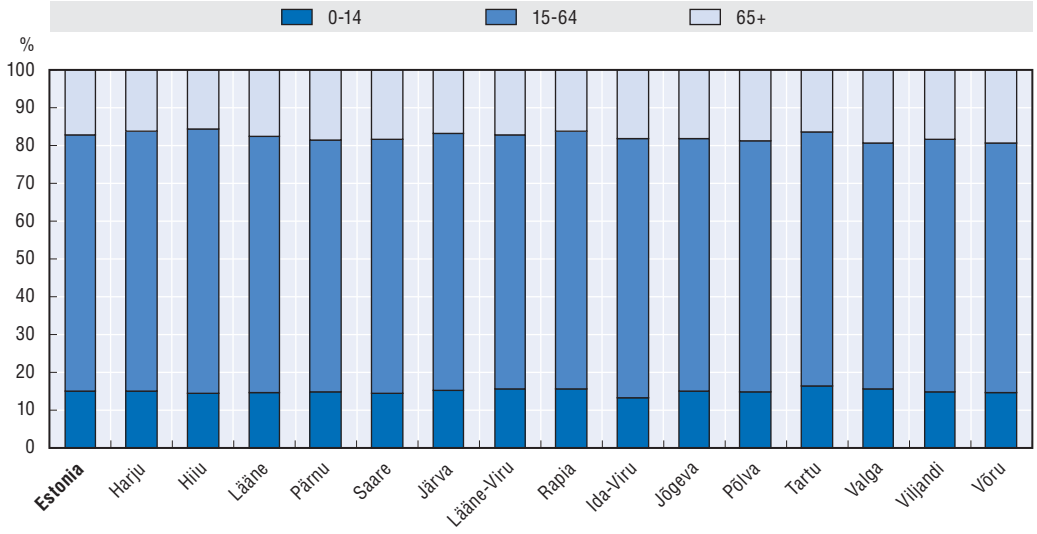
Administratively, Estonia is divided into 15 counties. The population size of these counties varies from about 10 000 on the island county of Hiiu to 525 000 in Harju County

(which includes Tallinn, the capital of Estonia). The population size of 11 counties is in the range of 27 000 to 88 000, and two counties have populations between 100 000 and 200 000; Tartu County (150 000), which includes Tartu City, and Ida-Viru County (170 000) in the north-east of Estonia. The number of cities and towns within a county varies from no municipal city at all *(e.g.,* Rapla County whose Rapla city/town does not have municipal status) to six cities ranging from 1 000 inhabitants to about 400 000 in Tallinn. In almost all the counties the total number of inhabitants in rural municipalities within the county outnumbers the total number of inhabitants in the cities (within the county),[6] with the exception of Harju county with the capital Tallinn, Ida-Viru County with its two big cities of Kohtla-Järve (44 800) and Narva (66 000), Pärnu County with Pärnu City (44 000) and Tartu County with Tartu City (103 000). In short, Estonia is not a big country measured in square kilometres, but it is dispersedly populated with a population density of 30 per km^2.

Each of the 33 cities and towns and 193 rural municipalities has a local government that operates independently and that is afforded a considerable amount of autonomy by the Estonian Constitution, in particular in relation to the central state government. Since local governments are responsible for the provision of social services to their local populations, the provision of social care services to the elderly in Estonia is dependent on local governments' financial and organisational capacity as well as their administrative and professional capabilities.

The share of the Estonian population over 65 years old living in the counties varies from 16% to 19% (see Figure 8.9), the configuration of social services for the elderly varies greatly between counties and the cost per capita varies even more.

Figure 8.9. **Estonian population by age group and county, 2009**



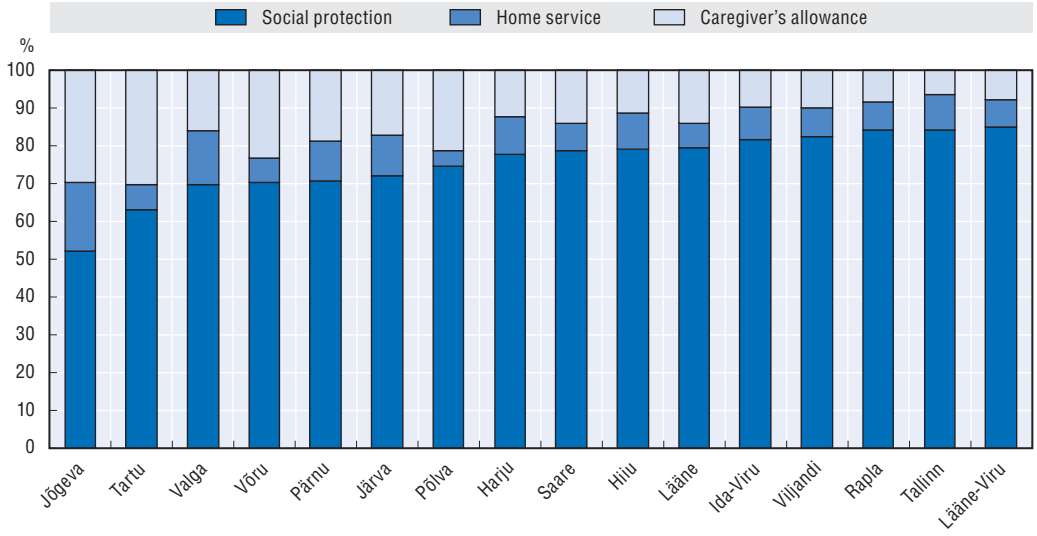
Source: Data provided by Ministry of Social Affairs (2010), Tallinn.

Where older Estonians are living – in cities or rural municipalities – differs greatly between counties. Extremes can be observed in Harju County, where 85% live in the cities and 15% live in rural municipalities, whereas in Põlva County only 15% live in a city and 85% live in rural municipalities. In 11 out of the 15 counties, more than 50% of the population 65 years and older live in rural municipalities.

In total, 64% of the Estonian population 65 years and older lives in one of the 33 cities or towns throughout the country, with a concentration of 29% of those aged 65 years and older living in Tallinn. However, in only four counties (Harju, Ida-Viru, Pärnu and Tartu) does the total number of inhabitants 65 years and older living in cities or towns outnumber the total number of individuals aged 65 years old and over living in the rural municipalities. Migration seems to be speeding up the rising old-age dependency ratio in the regions, making things more difficult to solve at local levels in Estonia. The risk associated with migration – *i.e.,* when younger people are moving from rural municipalities to towns and cities, leaving the older generation behind – is growing geographic inequality in terms of access to public services which follow from a declining local tax base.

The configuration of social services in the counties shows that social protection services are the main services provided (see Figure 8.10).[7] Within social protection, the expenditure on social welfare institutions for the elderly takes up the biggest share, on average 68% in Estonia as a whole. The share of expenditure on institutional care is lowest in Tallinn at 45%, and reaches 98% in Tartu City.

Figure 8.10. **Expenditure on social protection, home service and caregiver's allowance for the elderly, by county, 2009**



The figures for Tallinn are not included in the figures for Harju County.
Source: Data provided by Ministry of Social Affairs (2010), Tallinn.

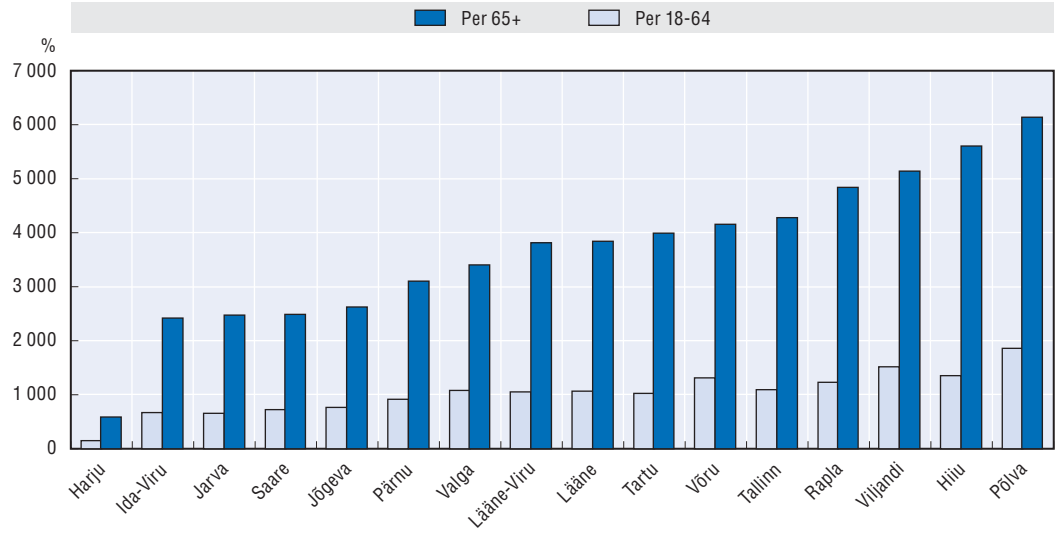
The cost per capita, in particular per inhabitant 65 years and older varies greatly between counties (see Figure 8.11). Variation in the level of population density, which limits the opportunity to exploit economies of scale, and the organisational configuration of services are the most likely explanations.

A fragmented system of care for the elderly

Responsibility for provision of long-term care in Estonia has been divided between the health and welfare systems. The health care system provides nursing care, geriatric assessment service and home nursing care services. The welfare system provides long-term care in welfare institutions, day centre service (day care), home care and housing services, and other social services, as well as caregiver allowances. The care of people with

Figure 8.11. **Total local government expenditure on social services for the elderly, 2009**

Per capita 65+ and 18-64



Source: Data provided by Ministry of Social Affairs (2010), Tallinn.

mental health problems is under the responsibility of Ministry of Social Affairs and care for old people (and also for people with severe physical disabilities) is under the responsibility of local municipalities (see Table 8.3).

Table 8.3. **Social and health care responsibilities for the elderly in Estonia**

Target group*	Care for older people (including people with dementia) and people with severe physical disabilities in working age	Nursing care for old people and people with severe physical disability
Type of services provided	Long-term care in welfare institutions; day centre service (day care); home care and housing services; other social services; caregiver's allowance.	Nursing care, geriatric assessment service and home nursing care services.
Responsibility	Local municipalities.	Estonian Health Insurance Fund.
Financing	Local municipality; client/family (over 60% of the price of service in the case of round-the-clock care; co-payments for community care services are rare and nominal).	Estonian Health Insurance Fund and patient (co-payments).
Authorising legislation	Social Welfare Act.	Health Services Organisation Act and other health sector regulation acts.
Needs assessment	Assessment provided by local municipality (social worker) together with family doctor or nurse. In more complicated cases, a rehabilitation or geriatric team steps in.	Assessment provided by family or other medical doctor, sometimes with intervention of a geriatric team.
	Co-operation between the social worker and family doctor in needs assessment process is not regulated by the law.	
Access to services	Local municipality (social worker) considers and chooses the appropriate form of care based on needs and financial situation.	Family or other medical doctor.
Professionals providing the service	Care workers.	Nurses and care workers.
Length of service provision	Depends on the needs of person and financial possibilities of local communities.	60 days for nursing care (can be prolonged in certain cases); home nursing care depends on the person's needs and finances.

* A third group that is outside of the scope of this study involves the care and nursing care for people with special mental needs, both in working age and older age (including intellectual disability and psychiatric diseases including schizophrenia), but not including people over 65 with dementia diagnoses.

Social services, including open care and social care homes for the elderly, became the responsibility of local municipalities in 1990s. The financing of healthcare, on the other

hand, is organised at the state level through the Estonian Health Insurance Fund (EHIF), which became an independent public body in 2000. The health insurance system is mandatory and financed by an earmarked social payroll tax. Being the responsibility of local governments, social services are financed by local government tax revenue, and some low-income municipalities get equalisation payments from the state, based on the social and economic conditions in the municipality.

It follows from this division of responsibility between the local government and the state that services like domestic care services, caregiver allowances, transport, day care centres and 24-hour institutional social care falls within the responsibility of local governments, whereas nursing care, physician services, rehabilitation, nursing care hospitals, special care hospitals and acute care hospitals are state-level services. Although the responsibility to ensure and finance these services lies with either the local governments or the state, services can be provided either by the public sector or contracted out to public foundations or to private providers (both for-profit and not-for-profit).

As a long-term care system, the Estonian system of care is fragmented. That, in itself, is not unique to Estonia. Health and social care systems as systems of care for the elderly tend to be fragmented all over Europe. The fragmentation of the Estonian care system, however, is multi-dimensional, imposing many costs on both users and the system itself. Fragmentation appears at the *financial level* with different sources of funding producing different incentives *(e.g.,* activity-based financing, *per diem* or global budgets) and different streams of finance *(e.g.,* Health Insurance Fund, local taxes, Social Insurance Board and users' contributions). Partly as a result of this, it also appears at the *organisational level* in a gap at the interface of health and social care in the community *(e.g.,* nursing home care and home services), and at the interface of acute hospital care and long-term care. Fragmentation appears at the *professional level* in a gap between different groups of dominant professionals inside the two different sectors *(e.g.,* social care staff and medical care staff). And it appears at the *operational level* in the way services are configured at local levels *(e.g.,* home services *versus* caregiver's allowance and public and private providers of care). Finally, fragmentation appears at the *policy level* in which decentralisation of responsibilities has been accompanied by a lack of appropriate instruments and limited resources to ensure accountability.

Financial fragmentation: Funding structures drive the provision of care

Since social services became the responsibility of local government in the 1990s, both the terms and conditions in which social services have to respond and operate have changed, due in part to demographic developments, but in particular as a result of hospital reforms. Ensuring equal access to an appropriate level of care services for the elderly across Estonia will take more than just re-organising local-level social services. In Estonia, as elsewhere in Europe, it will take no less than a concerted, integrated approach in which the funding and delivery of social care – as well as healthcare at the interface of services in the community and at the interface of acute hospital care and long-term institutional care – will have to be reformed. (See Recommendation 1.)

In the early 1990s, Estonia had about 120 hospitals with approximately 18 000 beds spread across the country. Since the early 2000s, major hospital reforms involving a large-scale downsizing of the acute care hospital sector, financial restructuring and reduction in the average length of stay in acute care beds have been implemented. Similar to many other central and eastern European countries, changes in funding incentives in the 1990s and 2000s led to an initial shift from general hospital beds to nursing care beds

in the 2000s, constituting a shift from long-term care to short-term care. Between 2000 and 2008, the number of general hospitals fell from 39 to 11, while the number of nursing care hospitals increased from 12 to 23. Over the same period, nursing care beds per 10 000 inhabitants aged 65 years and older increased from 39.9 to 63.1 (Ministry of Social Affairs, 2009). These nursing care beds are financed by the Estonian Health Insurance Fund on referral by a physician and with a time limit of two months maximum stay. Therefore these beds are not providing long-term care and, instead, are considered active rehabilitation beds.

This shift was a part of broader healthcare system reforms which took place in most eastern European countries after 1990 and involved a major downsizing of the hospital sector and shortening of the average length of stay in acute care hospitals. These reforms were generated by financial restructuring of the hospital sector in which different reimbursement systems were employed in order to create incentives for more efficient use of the most expensive units in the sector. Hospitals provide short-term services involving different degrees of active treatment, *i.e.,* different levels of hospitals, financed based either on activity-based costing and Diagnostic Related Groups (DRGs) in acute care or *per diem* for rehabilitation centres and nursing hospitals or eventually global budgets (Koppel *et al*., 2008). Acute care and diagnostic centres are financed on the basis of *activity-based costing* and rehabilitation on fixed *per diem* rates. This means, that since the most expensive procedures and episodes take place on admission to a hospital, the first days are the most expensive ones and as the rate of activity goes down, the days become less costly. An integral part of the hospital reforms and the financial restructuring was a more appropriate and efficient use of resources in healthcare. To make the most efficient use of expensive technology and to ensure return on capital investment, good hospital management involves effective discharge planning of patients who are not receiving active treatments, *i.e.,* eliminating "bed-blocking" is one of the objectives. This is particularly true in a hospital providing services financed on the basis of activity-based costing schemes like DRGs.

Prior to these reforms, many general hospitals were *de facto* long-term care beds since elderly people were staying for months or even years in general hospitals. Because general hospitals had, in the years prior to 1990, served the long-term care needs in eastern European countries, the concept of "nursing home" as a facility, *i.e.,* an institutional care in which old, frail and sick people receive comprehensive health and social care during the last months of their lives, did not exist. In the process of downsizing the hospital sectors, these long-term care needs of old people were shifted to the social care sector. Hungary is another example where this phenomenon took place. The Estonian health and social care sector is now experiencing a similar effect of hospital reforms driven by financial restructuring.

At the same time, long-term institutional social care for the elderly has also increased, and the cost of this type of care has increasingly been shifted from local government to the users of care. Figures from the Ministry of Social Affairs (Ministry of Social Affairs, 2009) show that the number of institutions providing 24-hour welfare services (not medical or nursing care services) for adults increased from 108 to 120 between 2003 and 2008 (11%), and the number of users increased by 37%. Figures on expenditure and financing of institutional welfare services for adults (excluding people with special needs, *i.e.,* people with psychiatric needs for whom services are provided and co-ordinated by central government, rather than by local governments), show that, in this period, cost per capita increased by 69%. Over this same period, the share of local governments in the expenditure

decreased by about 16 percentage points while the share of service users in the financing of these services increased by almost 17 percentage points.

The hospital reform in the 2000s is an example of how financial restructuring as a driver of change can be used as a powerful method to reform service delivery. An integrated approach to long-term care for the elderly requires financial restructuring. In such a financial restructuring, the link between rights and responsibilities has to be clear and unbroken in order to eliminate perverse incentives. This will result in a more diversified funding of an integrated approach to care, and thus make for a more sustainable mix of financing. As an overall financing scheme based on the principle of rights and responsibilities, the rights involve entitlements to services in case of established needs, whether for health or social care needs, and the entitlement ensures delivery of care wherever the elderly person is living. Responsibilities refer to duties, whether the duties of the person in need, his/her family, local governments, EHIF, Social Insurance Board or the State, to take their share in financing the necessary services. (See Recommendations 3 and 4.)

When making the decisions on who gets what, where and how much, the process of matching care to needs is important in order to improve efficiency in the use of resources. In making decisions on who pays, the process of matching right-based entitlements and responsibilities is equally important – not just to make better use of scarce resources, but also to avoid perverse incentives and to find more sustainable financing for long-term care services. The principle of rights and responsibilities thus translates here into the financing principle of "money-follows-the-patient".

Needless to say, implementing such a completely new approach is beyond the scope of local governments. This approach requires state intervention. Several questions arise: What should be the role of the state? What should the state do and how much?

Organisational fragmentation: The gap between the health and social care systems

The split between the health and social care sectors for elderly care may generate extra costs as a result of re-admissions to hospitals and inefficient use of resources at this most expensive end of the overall care system. Of equal importance, failure to explicitly address the critical issue of continuity of care means that current *ad hoc* efforts to solve major co-ordination problems across the sectors are resulting in elderly users being shuttled between different types of care, driven not by need, but by financing, thereby reducing their quality of care.

Fragmentation in the care of people with long-term and chronic conditions tends to result in an increased burden on emergency services and high re-admission rates to acute care hospitals. For example, re-hospitalisation within 30 days of discharge has become a major issue in the Medicare fee-for-service programme in the US (Jencks *et al.*, 2009). Re-hospitalisation within 30 days of discharge is not seen as a result of mistakes made in the hospital; rather it is seen as an issue of successful or unsuccessful transition of patients from the hospital to the community. When the transition is not well planned and organised, and people with ongoing problems or chronic illnesses and frailty are not properly taken care of in the community or in post-acute-care programmes, evidence suggests they end up being re-admitted to a hospital.

To follow a hypothetical case of an elderly person admitted to an acute hospital in Estonia, the process of admission and treatment begins at the most expensive diagnostic and acute care treatment level in the hospital. At this level, funding is based on *activity-based costing* in

which the cost of active episodes has been analysed, and reimbursement is based on DRG payment systems. The incentives involved in this payment system support the overall aim of the acute care hospital reforms, *i.e.,* to reduce the average length of stay in acute care hospitals. In such a payment system, effective discharge mechanisms to eliminate "bed-blocking" become important. If not discharged from the hospital back to where they came from, the elderly person may be transferred as soon as possible to either rehabilitation units or nursing care in which EHIF (Estonian Health Insurance Fund) funding is based on *per diem* rates and which allow a maximum stay of 60 days. An elderly person who is not well enough to stay at home and whose care needs exceed the level of care provided in social care homes may end up being re-admitted to an acute care hospital after staying at home for only a few days – and the tour through the hospital system begins again, resetting the eligibility clock for another maximum stay of 60 days in rehabilitation or nursing care hospitals.

If this process, including the 60 days of maximum stay (two consecutive months) paid by the EHIF, can be defined as "a push-out mechanism", *i.e.,* a mechanism designed to reduce patient stays in hospitals, there is another which can be defined as "a pull-out mechanism", that is, a mechanism which puts pressures on the patients themselves to leave hospitals within 60 days. This second mechanism is the right of retired persons to receive social benefits based on the provisions of the *Social Benefits for Disabled Persons Act*. According to this Act, a disability allowance for a person of retirement age shall be paid monthly to a person of retirement age with a moderate, severe or profound disability for compensation for the additional expenses caused by the disability and, upon existence of a rehabilitation plan for the activities prescribed therein – except for the activities financed from the health insurance and other state budget funds. The allowance shall be paid monthly in an amount equal to 160% of the social benefit rate to a person with a profound disability, in an amount equal to 105% of the social benefit rate to a person with a severe disability and in an amount equal to 50% of the social benefit rate to a person with a moderate disability. The rules on disability allowance state that the payment of social benefits for disabled persons shall be suspended if the recipient of benefit is hospitalised for more than two consecutive months.

Due to a lack of standard data, it is not known whether elderly people in Estonia are experiencing unnecessary admissions to hospitals due to lack of appropriate discharge planning or lack of appropriate services in the community. A medical doctor interviewed in Estonia in June 2010 put it this way:

> "The rate of hospital re-admission due to too early discharge from hospitals is not known, but after discharge whether from an acute care hospital or a nursing care hospital it is very common that clients and their relatives start looking for another nursing care hospital to apply for a place because the elderly person can't stay at home. So elderly people in need for health and social care often end up moving between hospitals and nursing care facilities since both these are short term in Estonia, and there are no such places where old people with straight forward long-term healthcare needs and social care needs can move to and live until they die. There is no long-term care insurance in Estonia."

The new UK Health Secretary, Andrew Lansley, has made a policy pledge to penalise hospital trusts in England where patients are re-admitted within 30 days (British Broadcasting Corp., 2010). Hospitals will be paid for initial treatment, but not paid again if a patient is brought back in with a related problem. It has been argued that patients are being discharged

early to free up beds. This is part of a drive to ensure that treatment in secondary care is joined up with services in primary care and that patients with long-term conditions are not trapped in a cycle of hospital admissions. In short, in the payment system of acute care hospitals there are well-known perverse incentives which make the interface between acute care hospitals and long-term care more difficult to manage. There are well-known risks involved in shifting frail old people from one system to another: risks involved in accidents in transport, and misunderstanding and loss of information (Leichsenring *et al.*, 2005).

Professional fragmentation: The gap between the health and social care systems

The sector divide between the health and social care systems in Estonia means that there are two care systems with different sources of financing, different groups of professionals, different sets of organisational norms and cultures, and different social status and prestige. This is despite the fact that the two systems fall within the jurisdiction of a single government department.

Health services – *i.e.*, medical care or nursing care – are not the responsibility of local governments and cannot be provided by local governments in their social care homes since the EHIF does not contract with local authorities. The EHIF practices selective contracting, and contracts are made only with providers licensed to work in Estonia by the Health Care Board. Residents in social care homes only get medical and nursing care by an individual prescription on a referral issued by the family doctor (Koppel *et al.*, 2008).

Service providers who operate at the interface of health and social care for the elderly – such as rehabilitation centres and geriatric assessment teams – find themselves operating in a "gray zone" in which more and more people in need of long-term integrated health and social care keep moving between different facilities. Yet the sector specialisation in the social and health professions leaves service providers poorly equipped to deal with the unique problems faced by the elderly. Services for older people, in particular those over 80, are in general labour intensive, and complex in the sense that they deal with a wide range of social and healthcare needs, which require multiple skills to meet in a well-informed, and co-ordinated and collaborative fashion.

Estonia's small labour market, accompanied by the lack of financial and human resources, requires it to make the most out of its limited means. The gap between the health and social care systems, and the fact that longer life expectancy in Estonia involves a growing number of elderly Estonians living longer with conditions from multiple diseases which are at the same time medically more complex and socially more fragile and vulnerable, means that a completely new approach to meeting the actual care needs of the elderly in Estonia is needed. Estonia needs skilled staff, specially trained to work at the interface of two different sectors where co-ordination of tasks and work processes is crucial.

Operational fragmentation: The mix of social care provided

A lack of regulation of the elderly care sector means that municipalities are free to choose the mix of social services to meet elderly needs, according to their own assessment and criteria. Matching care to needs in order to maximise the most efficient use of resources requires administrative, organisational and professional capacity and capabilities, which are missing in most local governments in Estonia. Hence, the type and level of services provided do not only depend on local governments' financial capacity, but also on their administrative, organisational and professional capacity and capabilities. (See Recommendations 2, 4 and 5.)

Particular attention should be paid to the amount of caregiver's allowance relative to expenditure on home services. Since planning and providing professional home care involves organisational and administrative costs, local government officials may be tempted to minimise that cost by using caregiver allowances. Over the long-term, it will take a longer time to build up organisational capacity and to accumulate professional skills and expertise. Thus, the capabilities for providing both flexibility and continuity of care across a bigger group of home care recipients will not develop. In addition, local governments will lose the opportunity to build up the necessary stronger professional counterpart to other providers of elderly care in the community and to hospital care providers.

A more professional approach to organising home care ensures better information and thus a better match between care and needs. Moreover, in the context of state and local government policy, which emphasises independent living of elderly people in the community, professionally organised home care services at local levels are the pillars in the implementation of such policy. Therefore these services should be organised as mainstream services and actually form one of the strongest links in the so-called service chain which operates both at the interface of social and healthcare services in the community and at the interface of hospital services and the community as a critical partner in hospital discharge planning. In short, organising professional home care services at local levels is about building organisational capacity and administrative and professional capabilities. (See Recommendation 2.)

Continued reliance on a caregiver's allowance reduces the ability to establish organised home care services on which service capability and capacity could be built at local levels. Hence, the use of caregiver's allowance is a fragmenting element when it comes to the question of improving co-ordination and quality of care by means of staff trained for organised social service provision.

Policy fragmentation: A provider-driven care system

The system of health and social care for the elderly in Estonia is provider-driven rather than user-focused or client-centred. That is, who gets what and how much services depends on the existing type and level of services, and where and how these services are organised and financed – rather than based on an assessment of individual users' comprehensively assessed needs. The only way to get a full picture of user needs in Estonia would be to analyse social care services for the elderly county by county, which was not in the scope of this case study. Even then, it would be very difficult to develop a coherent picture. As there are no common nationally standardised needs-assessment procedures or evaluation criteria for determining the type and levels of users' needs, it is not possible to have comparable data that would enable a cross-country comparison of who is served, the level and scope of their needs, the level of unmet need, and whether or not there are people on waiting lists. Therefore, whether the right level and type of needs are being prioritised and thus met at the right time and at the right place is difficult to determine.

Thus, it is not currently possible to develop an assessment of overall elderly needs in Estonia that can be used to drive and shape the provision of social care services and to match needs with care provision in an optimal fashion. Instead, in a fiscally tight context, service provision and allocation will have a tendency to be driven by providers' economic pre-occupations of meeting operating costs on existing infrastructure, reducing service delivery costs and shifting costs onto users.

The current process of assessing needs and then distributing resources in terms of social services is not a transparent process. Without a standardised needs assessment tool, needs are determined locally and the process and procedures vary across the country. Local governments are both the largest providers of care as well as the entities responsible for carrying out the needs assessment based on their own criteria. As there is no third party doing the assessment for institutional care – the service area which requires a financial contribution from the elderly and for which local governments charge the biggest co-payments – there is a potential for a conflict of interest as municipalities seek to meet fixed costs by filling the beds in municipally-owned facilities. Very few care professionals or managers interviewed by the OECD mention long waiting lists (except in the case of rehabilitation programmes), one sign that there may be over-capacity of care beds. Improving the allocation of bed spaces and better matching needs to supply could help municipalities reduce their operational costs. The scarcity of examples of inter-municipal co-operation, however, seems to show that this possibility for increasing efficiency has not been adequately developed (see Chapter 6: "Delivering Public Services Effectively").

The lack of standardised comprehensive needs assessment means that care providers in Estonia are responding to imperfect information regarding the level of care needed. Nationally, the provider sector's response is likely to result in inefficient use of scarce resources because the link between actual needs and the type and level of services provided is ambiguous. In interviews with the OECD, some municipalities claimed that they were building their own social care facilities because this was the only way to assure the quality of care. Such an attitude overlooks the contractual and licensing options already available to municipalities to assure the care quality, but it also reveals the extent to which a lack of standardised measures can be used as an excuse not to work with other municipalities, as well as private or non-profit care providers.

One of the consequences of an unregulated provider-driven system of elderly social care as described above is that it can make the elderly and their families more vulnerable to exploitation. Owners/operators of care homes have incentives to select elderly people who are "light" in terms of needs for care and whose ability to pay is high, *i.e.,* they may be skimming clients. This type of behaviour may lead to inefficient use of resources, since there in no way to ensure that the existing services are being used for those with the greatest need for services at any given time. In Estonia, family members and relatives are obligated by law to support their older parents or family members financially in case they run out of funds to support themselves. In effect, this allows owners/operators of care homes to begin by exhausting the elderly person's ability to pay, and then turn to the elderly person's children or relatives before local municipalities pick up the bill. This provides further incentives to prioritise the use of institutional care since relatively high cost sharing in terms of users' co-payments is guaranteed. In this way, the costs of providing social services to the elderly has been shifted from local government to the users and may, due to financial ability to pay, negatively affect access to services.

Another characteristic of provider-driven systems is that money follows the providers, not the users. The flow of funds tends to be rigidly fixed to defined types of providers and pre-determined packages of the type and level of services provided. The result is often known as either "dumping clients" from one service sector to another or shifting the costs of care to clients. The former takes place at the interface of health and social care. The latter happens within the social service sector in the absence of common standardised evaluation criteria where providers of services who also make individual decisions on

service delivery may be tempted to give priority to services for which users' co-payments are higher (*e.g.*, institutional social care as opposed to home care) or for which local governments' organisational and administrative costs can be minimised (*e.g.*, caregiver allowances as opposed to home care). This is possible in the absence of good information which otherwise would put pressure on local governments to better match care to needs.

Provider-driven care systems tend to be more fragmented with many different independent providers. This is a well-known source of increased co-ordination problems (see Box 8.1). Although diversity, choice and competition may improve service delivery, a service sector which is largely unregulated like the social care sector for the elderly in Estonia may increase the level of fragmentation of the system, diversify the level of competing interests and lead to rising costs of co-ordination.

Box 8.1. **Mixed delivery of care complicates integration of services to individuals**

While in Finland and Denmark, services are mainly provided by local public organisations, in France and Greece, a mix of different providers (public, private non-profit) calls for co-ordination rather than integration of services, thus complicating the task: "… it is important to overcome the interests of each single association or entity in order to serve together the interest of the older people. This seems to be the most difficult to achieve."

Source: Leichsenring, K., G. Roth, M. Wolf, and A. Sissouras (2005), "Moments of Truth. An Overview of Pathways to Integration and Better Quality in Long-Term Care", *in* Billings, J. and K. Leichsenring (eds.) (2005) "Integrating Health and Social Care Services for Older Persons. Evidence from Nine European Countries", *Public Policy and Social Welfare*, Vol. 31, Aldershot (UK): Ashgate/European Centre.

The international policy context

In the 1990s, concern grew within the European Union regarding health and social care services for older people. This can now be seen within the European social policy and social protection agendas, as well as the research agenda. A critical political push for concrete actions on social protection came in March 2000 with the start of the Lisbon Process. This process set out to introduce new instruments to enhance a comparative approach in order to promote social policies, *i.e.*, the "Open Method of Co-ordination" as the driving force behind the development of European policies and co-operation between the member states in the realm of social policy. This open method relies on soft law mechanisms such as guidelines and indicators, benchmarking and sharing of best practice and thus includes:

- fixing guidelines and timetables for achieving short-, medium- and long-term goals;
- establishing quantitative and qualitative indicators and benchmarks, tailored to the needs of member states and sectors involved, as a means of comparing best practices;
- translating European guidelines into national and regional policies, by setting specific measures and targets; and
- monitoring the progress achieved periodically in order to put in place mutual learning processes between member states.

The process is expected to produce improved mutual learning and peer review, identification of good practices and their conditions for transferability, and development of joint policy initiatives among several member states and regions.

The health and long-term care strand of the Open Method of Co-ordination focuses on indicators related to social protection. It is structured along the three objectives of the health and long-term care strand (European Commission, 2010):

- access to care and inequalities in outcomes;
- quality of care; and
- long-term sustainability of systems.

Research at the European level based on nine European countries, has brought out evidence which illustrates different approaches and models of integrating health and social care for older people (Billings *et al.*, 2005). The research identifies two of the most crucial interfaces of health and social care. First, the interface between nursing home care and other social services and the co-ordination of different professions and providers in community care *(e.g.,* home care, home help) should be considered an indispensable first step towards integrated care delivery. Second, the research identifies the interface between the hospital and long-term care facilities as "the classical case for bottleneck between health and social care systems". It brings out the all too well-known and all too common scenarios of older people (Billings *et al.*, 2005):

a) who are living alone in normal houses or apartments with functional incapacities after illness and disability, needing a range of different services;

b) who are discharged from hospital with long-term care needs, who suffer from geronto-psychiatric and/or diseases of old age;

c) who have chronic-degenerative diseases and are at risk of losing their autonomy.

These are situations which may become visible or occur at a very short notice, since a situation of stability can turn into a situation of emergency with no warning. "Such emergencies", the authors say, "are the 'moments of truth' for social and healthcare systems with respect to their ability to respond to the needs of older people" (Billings *et al.*, 2005).

The EU member states are concerned and are looking at various mechanisms to address the expected increase in demand for long-term care services in light of the demographic ageing of the population and the prevalence of disability and dependency, particularly among the elderly. A review of EU member states' national reports from 2006 on healthcare and long-term care focuses on long-term care in particular and analyses the main challenges the member states are facing, and their strategies to tackle these challenges in the field of long-term care in light of common objectives. Member states are striving to ensure a sustainable mix of public and private sources of finance to meet the foreseen increase in demand for accessible, resource-efficient and high-quality long-term care provision. Measures include changes in financing mechanisms. But being committed to ensuring near universal access to long-term care, the individual ability to pay or the share of private sources of financing should not hinder that accessibility.

The member states' national reports from 2006 highlighted a trend: where available, care in a community or residential setting is preferred to care provided in an institutional setting. Member states are committed to a high level of quality in the care provided in a residential or community setting and are striving to ensure such a level. Measures include uniform standards and quality accreditation mechanisms coupled with legally enforced evaluation methods. Where they do not currently exist, efforts are being made to implement equivalent quality assurance and accreditation mechanisms. Finally, there is a widespread consensus on the need to address the expected workforce shortages in the long-term care

sector, *i.e.,* the formal care, as well as devising new ways to support family or informal carers. Adequately recruiting, training, and re-training long-term care workers remains a challenge. Several measures are being implemented including higher wages, the improvement of training and working conditions and the formalisation, where possible, of informal carers into the social security schemes. In short, the member states are committed to the common objectives of accessible, high-quality and sustainable healthcare and long-term care (European Commission, 2008).

This international policy context confirms that concerns about inequality of access to affordable quality services for the elderly are not unique to Estonia. The good news is that the Estonians do not have to re-invent the wheel. However, in every country there are situations, patterns and elements which are unique and which need to be explored, analysed and better understood. Common objectives and indicators at the European level cannot and should not be strived for without having developed objectives and indicators which are common "at home", *i.e.,* common for the Estonians. The process of policy learning and development involved in preparing a long-term policy for Estonians is and will be unique for Estonia. Such a process can never be imported like a product, rather it has to be generated, driven, learned and lived by Estonians themselves. Ideas, policy solutions and best practices from other countries are useful, but only if these are well understood in their own context and adapted with respect to local circumstances in Estonia. The process of formulating long-term care policy in Estonia should be informed by what works and what does not work elsewhere, but long-term care policy should first and foremost draw on knowledge and evidence from Estonian reality.

To summarise the international policies, programmes and practices which are relevant to the Estonian context, the following trends which have become widespread in Europe stand out:

a) **Care in the community or in an independent residential setting is preferred to care in institutional setting,** *i.e.,* old people want to stay in their own homes and maintain an independent way of living as long as possible and thus arrange for home delivery of health and social services when needed. This suggests that home services – both health and social care, for example, nursing care, home help, meals-on-wheels, physiotherapy, social work, transport and other services suitable to be delivered in domestic setting – are and will be in high demand.

b) **Common and standardised evaluation or assessment methods are being used to promote uniform needs assessment.** Needs assessment is a crucial step in the realisation of integrated care and must cover all relevant life domains of the person who require services, *e.g.,* physical, mental, social, functional and financial. The available supply of care should not form the basis of the needs assessment. Instead, the primary consideration of this common comprehensive approach is formed by the client's needs, *i.e.,* supply follows the demand. The practices are more or less extensive depending on whether they take place at the interface of health and social care in the community or at the interface of acute hospital care and long-term care. However, whether a comprehensive, multi-disciplinary approach or a simpler approach, assessment procedures will have to meet at least three requirements:

i) They should be comprehensive to cover the client's needs for health and social care.

ii) They should be understandable for the clients: simplify the procedures for access to services, reduce/facilitate administrative activities, and ensure effective information about available services and their cost.

iii) They should be manageable, not time-consuming, and give clear indication of services needed and efficiently designed for monitoring purposes.

c) **Limited horizontal integration of services in the community** in which the nursing care in the community and home help (*e.g.* help in daily living, shopping, dressing and preparing meals, personal hygiene, eating) are moving closer together; basing their work on multidimensional needs assessment, shared individual care plans and common objectives. Sometimes integrated community care models involve a merger of two separate organisations of nursing care and home help as a starting point for further networking with cleaning services, rehabilitation services, other support services or geriatric multidisciplinary teams. However, there are concerns that social services would either lose their identity and autonomy or become enmeshed in the "medical model" and thus there seems to be opposition to full horizontal integration, in particular if such integration takes place under the umbrella of healthcare.

d) **Case management is an approach which plays a key role in co-ordinating services.** In this approach one professional, often a social worker, takes on the role of a case manager. The case manager takes care of the user during the transfer from one service to another and manages the relationship with users and caregivers. The basic idea behind the approach is that there is one person maintaining a holistic view of the client's individual care plan, mobilising the existing services available to meet current needs and assess the possible future needs, and maintaining counselling and informative contacts with family members as well as informal and formal care providers.

e) There is an **emerging pathway of care**, **a continuum of care often referred to as "a service chain"** in which the lowest level of care begins in the community and progresses into higher levels of care with permanent admission to a nursing home with fully integrated in-house health and social care services. An example of such a continuum of services begins in the community with meals-on-wheels, home help, recreational activities, transport, purpose-built housing with different degrees of services involved, nursing home care, day-care, respite care, rehabilitation services; the management of care (by a case manager) aims to exploit the lowest levels of care before turning to permanent admission to institutional nursing care in nursing homes. Improved housing stock, purpose-built housing and the variety of support services in the community is replacing institutional social care, and standardised comprehensive needs assessment and well-managed individual care plans are shortening the stay in nursing homes since clients are moving into nursing homes at a much later stage.

f) **A search for a sustainable mix of funding for long-term care** is common among most European countries. Most countries have at least two, three and sometimes four streams of financing for long-term care and almost all rely to a certain extent on users' contribution combined with either long-term care, health or social insurance schemes or taxes (national, regional and/or local taxes), social assistance (means-tested/non means-tested) or state subsidies.

Nowhere in Europe has the mission involved in implementing an efficient long-term care policy been accomplished. The mission is in progress and often it takes the form of an experiment in which programmes and practices are transferred from one system to

another and tailored to new circumstances in order to find the best cultural, social, organisational, political or financial fit. The World Health Organisation (WHO) has urged all countries to address long-term care as they further develop and reform their health and welfare systems (World Health Organisation, 2003).

The challenge for Estonia

Estonia faces many economic and social challenges simultaneously. The current economic recession is, of course, one of them. Although the impact of the recession on the Estonian economy may temporarily overshadow the challenge of the demographic factor, the challenge of a shrinking workforce relative to people of non-working age is there nevertheless and will be there for years to come. At the same time, tight municipal finances and vulnerable elderly populations will require state and sub-national governments to work in new ways to maximise scare resources and to provide quality services.

The economic recession may amplify the differences in access to social services across cities, towns and rural municipalities in the country and thus geographic inequality. Moreover, the impact of the recession on families and family relations may lead to breakdowns of the traditional inter-generational support and reduce capacity to provide help or contribute financially to organised care services for elderly family members, thereby placing additional stress on the social care system.

Estonians have a clear preference when it comes to services for the elderly. They are right to emphasise that the elderly should be able to live independently as long as possible in their own homes and that the provision of care services to the elderly should be part of their open care system and thus always begin at the lowest possible level of care, *e.g.,* meal-on-wheels, transport, home help and the like, based on an individual agreed assessment of needs. In the context of a fragmented care system in Estonia, however, realising this view entails a major political, administrative and professional challenge, since it cuts across levels of governments and across service sectors in which interest groups have major influence and indirect power by means of professional autonomy. Such a single government approach is needed in order to better manage and integrate services at the interface of health and social care in the community.

This case study shows that it takes more than just a social services reform to ensure a better service delivery to the elderly in Estonia. There is no quick-fix or a simple strategy to follow. Imperfect information and a lack of incentives have skewed the delivery system for elderly care in a direction that is not fiscally sustainable and that may not be optimising scarce resources. A systemic response and approach is required; it is beyond the scope and control of local governments alone to change the system. One of the results of the fragmented care system is that municipalities have traditionally found it difficult to co-operate with one another (see Chapter 6: "Delivering Public Services Effectively").

As it currently exists, social care for the elderly in Estonia is very lightly regulated. Municipalities determine the level and type of service and the county only investigates in cases of user complaint. Without a regulatory framework, the incentives are in place for a "race to the bottom" as both public (municipal) and private care providers seek to serve those persons with the greatest ability to pay (either directly or through co-payments), while providing lower-quality services to those least able to pay. This is particularly the case in the context of unsustainable municipal finances (see Chapter 6: "Delivering Public

Services Effectively"). Evidence shows that municipalities are already increasingly shifting the cost of care onto clients.

The more or less unregulated social care sector may offer competition on prices as well as service quality. Without nationally standardised needs assessment procedures or criteria, however, to define and link service requirements to user needs, this competition can compromise the quality of care since the link between prices and quality of care is undefined and thus ambiguous. This incomplete information can create distrust and prevent local government officials from contracting with private providers. On the other hand, in a case where local governments – which most often are the dominant provider of care services themselves – were to become the regulators of privately provided care services within their jurisdiction, there is potential for conflict of interest. This presents a clear case where the state needs to help regulate elderly care provision in which local governments are themselves active providers.

Putting the incentives in place for coherent care provision requires greater transparency about care needs, service provision, prices and quality of care. Due to imperfect information, service needs are unclear and incentives are not in place for optimal investment in human resources and infrastructure, on the one hand, and for co-operation across sectors and municipalities, on the other. Solving these gaps will require improved co-ordination across the state, county and municipal governments. Pre-conditions for establishing a level playing field for the care market include:

- A stable regulatory environment, including standardised information and criteria for needs assessment.
- Information and transparency about service needs and quality of the provision of service.
- A division of responsibilities *(e.g.,* needs assessment, service provision, and monitoring) that reduces conflict of interest and barriers to entry.

Creating a regulatory framework will require state intervention. Some have argued that the state does not have a right to intervene because of the legal independence of municipalities, but as elderly social care is a compulsory local service, ensuring its quality remains a responsibility of state government. A bigger dilemma is how to establish a regulatory framework without creating new mandates that lack accompanying resources. One solution would be to introduce service standards gradually with increases in municipal grants. Another would be to link standards to optional additional grants as in the case of meal subsidies in US Family Day Care Homes (see Box 6.27 in Chapter 6: "Delivering Public Services Effectively"). It is important that the regulatory strategy keep in mind the low levels of financial and administrative capacity currently at the municipal level for regulatory compliance.

The current lack of resources means that Estonia should focus on establishing standards for assessment and data through a comprehensive, nationally standardised, needs-based instrument for elderly care, rather than immediately setting national elderly care standards that stressed municipalities will not be able to meet. At the same time, however, the state should be putting the foundations in place to develop a national dialogue about care expectations, building evidence to support policies, and putting local capacities in place to implement standards once they are ready. Such an approach puts the immediate emphasis on users' needs for making individual decisions about the type and level of services to be provided. At the aggregated level, such a comprehensive needs assessment

could help translate into a demand to which care providers, whether public or private, can respond more efficiently.

A nationally standardised needs assessment programme would provide measures to ensure that equal needs get equal treatments and thus to improve geographic equality based on more user-focused services. The process of matching care to needs, *i.e.*, defining and providing services on the basis of standardised individual assessment of needs, is a pre-condition for activity-based costing of services and the first step in shifting the financing of services towards a more diversified scheme of financing long-term care services for the elderly. In such a scheme, money follows the user, contributing to a more user-focused approach.

It is also a necessary first step for a greater private sector role in service provision. While municipalities can currently contract service delivery to the private and non-profit sectors, many have chosen to build their own care facilities. Currently, private providers are already providing a growing share of services to those who can afford to pay for them, so competition is growing between public and private care markets for those elderly who can most afford to pay for services.

The entry of private providers into the care market involves investments based on return on investment calculations taking into account the current regulatory environment. Changing service standards after private providers have entered the market could open the state to legal challenges. Instead, it would be preferable to work with municipalities to developed staged, voluntary guidelines for use in service delivery contracts – should they wish to contract out to the private market; and to help develop local capacities for contracting and licensing in order for municipalities to have a better say in the quality of services provided by third parties. Such an approach would provide greater predictability for a move towards national standards at a future point in time.

Due to the small size of most local governments in Estonia, and the accompanying problems related to economy of scale, a comprehensive standardised needs assessment may need to be administrated and co-ordinated at the county level, while allowing "a care market" of different service providers to develop at a broader level, for example through multi-county co-operation. While the role of the county in Estonia will ultimately be a political decision, the elderly social care domain provides a good example of where a regional approach would help to work against conflicts of interest and improve inter-municipal co-operation (see Chapter 6: "Delivering Public Services Effectively").

Over time, standardised data county-by-county and at the national level would provide a basis for the further development of care standards – as resources increase and as a consensus is developed about the level of care Estonia wishes to provide for its elderly. But such data also needs to be interpreted in light of Estonia's own policy goals and objectives in this sector. Estonia needs a long-term care policy in two parts: the provision of long-term comprehensive personal care to people in need, on one hand, and education and training of a skilled professional labour force, on the other. To serve its people, the government has to invest in its people. This calls for two actions: one which entails the preparation of long-term care policy and the other of a programme designed to address the needs for appropriate skills and knowledge to manage processes of co-ordination between the health and social care sectors.

What exactly the state should do in terms of specific actions and tasks and in what order is impossible to prescribe. There are no blueprints or manuals in circulation on how to

design an effective long-term care policy and how to implement such a policy. Almost all European countries are faced with the various challenges which follow from the ageing of their population. In most countries one can observe that the responses at the level of policies and programmes are broadly similar, but at the level of practice, the implementation varies in line with national and local differences of institutional settings, size, culture, political priorities, and historical and economic development. The process of implementation is a process of learning and adaptations in which lessons from others are tested, modified and tailored in order to find the best fit for local circumstances.

It is, however, important to be specific about the role of the state in achieving the necessary systemic reform, *i.e.,* clarity regarding the role of the state, rather than what specific actions it should undertake. The circumstances described above require the state to adopt a stewardship role (see Chapter 4: "Promoting a Whole-of-Government Approach"), as opposed to that of a principal dealing with its subordinate agent in a case of agency loss, *i.e.,* where the agent has failed to deliver on the principal's expectations, leading the principal to either exert firmer control or to recentralise all responsibility under its own authority. As the steward of state policy, the state should look at how to focus local governments, other stakeholders and the citizens of Estonia as a whole on a shared interest in improving long-term care outcomes for the elderly. In maximising its own interests, the steward seeks to maximise the stakeholders' interests as well. A steward's style of governance should be used as a means to facilitate and empower rather than to command and control. A stewardship role involves communicating at the outset to generate the level of trust and policy commitment needed to embark upon a project of the type discussed in this case study. It should be remembered that a long-term care policy takes a long-term commitment to follow through before results materialise.

Finally, long-term care policy, which involves shifting resources from one programme to another, requires commitments across political parties and major stakeholders to drive through a policy which takes a long time to mature and deliver. It requires political leadership, courage and will to be flexible, and the readiness to re-allocate existing resources to achieve new policy goals in line with new policy priorities. The formulation of long-term care policy involves fundamental rights and builds on the way that Estonians think about themselves as a nation in the community of nations to which they relate. More importantly, addressing the challenge of an ageing population requires changes in attitudes, strategic insight based on evidence and respect for the process of ageing, and the ability to learn from others.

Recommendations

The following recommendations should be considered as a holistic approach to the pressing issue of how to address the needs of an ageing population in Estonia in the context of fragmented health and social care systems and limited resources in times of a deep international financial crisis. Being holistic, steps involved in each recommendation go hand-in-hand with one another, *i.e.,* the recommendations depend upon one another for achieving successful outcomes. The five recommendations cover strategies which address the issues behind the main trends in international policies, programmes and practices mentioned in the earlier sections. These strategies are seen as relevant for Estonia. The recommendations should be considered as suggestions to guide the broader strategy on how to move forward and formulate and implement policies on long-term care. With that in mind, a practical action plan needs to be pulled out from this list of

recommendations to guide the first steps in the broader strategy. Several first steps are suggested as a starting point. These include:

1. **Formulate a national long-term care policy in Estonia:** Finding a direction and path for long-term care policy in Estonia will require vision. This is crucial due to the nature of long-term care policies and the nature of the process by which long-term care policies are implemented. A clear vision about where Estonia wants to go in this matter, how it will get there and who has to co-operate and collaborate in order to get there needs to be clarified. Therefore, a working party has to be set up with the remit to prepare a "white paper", *i.e.,* a policy document which states the vision, the objectives, the necessary approaches, key stakeholders – and identifies the regulatory implications that follow.
2. **Build a common understanding of user needs as a basis for greater collaboration:** A user-focused approach to elderly care depends on the right mix of skills and case management. Establish teaching programmes in gerontological studies and geriatrics in one of the universities in Estonia, and educate and train a stock of case managers to operate at the interface of health and social care in the community and at the interface of acute care hospitals and long-term care.
3. **Eliminate barriers and disincentives to more effective use of resources:** Sustainable financing of care will likely depend on more diversified funding streams. Assemble a group of experts and stakeholders to discuss, debate and develop options based on newly published reports and research material for: *a)* mixed financing of long-term care; and *b)* a move towards integrated delivery of health and social care for the elderly. It is important to clarify that this group is bringing in technical expertise to develop options regarding how to create more diversified streams of financing in order to make long-term care less dependent on local government budgets and users' co-payments. The option selected will be determined by the policy choice resulting from the "white paper" approach since the financing scheme selected has to be instrumental in achieving that policy.
4. **Establish a more consistent and coherent needs assessment instrument:** Improving the quality and equality of care begins with a common (and comparable) understanding of needs. Consider a simplified computerised version of standardised needs assessment in Estonia to begin with, while a more sophisticated instrument is under development. This is a crucial strategy in order to improve information on the provider care market and make the most efficient matching of care to needs.
5. **Define desired outcomes in order to establish and sequence realistic goals:** Operationalise the vision for elderly care by establishing performance indicators and service specifications; build up an evidence base on the Estonian elderly population for improving policy through research and development.

Formulate a national long-term care policy in Estonia

The Estonian government could steer a plan in which stakeholders at all levels (local, county and state), user groups, care providers, public, private and NGOs would be mobilised and entrusted with the task of creating a vision on which the Estonians would like to see a national long-term care policy be based. This plan could start with a conference on ageing in Estonia in which stakeholders and national and international experts could meet and share ideas, knowledge and practices. The product could be a "white paper" which would bring out the vision and principles on which to base a long-term care policy for Estonia.

Long-term care policy requires a vision based on strategic insight drawn from knowledge and respect for the process of ageing. One way for policy makers to think about long-term care is in terms of the service needs for future generations of elderly people, *i.e.,* services for themselves and today's working-age population. The implications of this is that policy makers should conceive of and design services and systems of care in a way acceptable for themselves or their closest relatives in the case of need. Voluntary organisation and charities across Estonia, together with sub-national governments and key stakeholders, should be mobilised and become engaged in the development of appropriate piloting and policy programme development towards the implementation of a comprehensive long-term care policy. One of the objectives of a new policy is to improve information in order to assure quality of care and create trust in and among providers of care for the elderly. Currently, private providers in Estonia find entry to the care market difficult, if not impossible. The state, local governments, public and private providers, and the elderly and their families all stand to gain from a policy which involves better information on the care market and thus ensures quality as well as a better match of care to needs. In Finland, experience over nine years from the collection of comparable standardised data on care outcomes is believed to have revolutionised both the efficiency and quality of long-term institutional care (Finne-Soveri *et al.*, 2010).

The "white paper" should present a regulatory impact analysis and identify all the legislative changes necessary to implement long-term care policy for the elderly and to achieve it policy goals. A systemic and comprehensive approach to policy change as recommended here will not be possible without either a change to legislation and/or new legislation. For example, systematic and standardised collection of data to ensure quality of long-term care and thus improve information on the care market is widespread in Europe (Eurohealth, 2010). In the Netherlands, England, Austria and Iceland, comprehensive quality frameworks exist and are supported by legislation either at the level of provinces (Austria), the state (England and Iceland), or as in the Netherlands, by parliamentary decision. Also, in Finland, France and Greece, legal regulations were introduced on a national level to co-ordinate and/or integrate home care services (see Box 8.3). Systematic collection of data to ensure quality of care requires participation of all providers of care, public and private. Therefore, it needs to be supported in legislation.

Build a common understanding of user needs as a basis for greater collaboration

The Estonian government should think about a long-term care policy in terms of a programme designed to improve co-ordination across the health and social care systems with the aim to maximise financial, as well as human, resources in both sectors. Estonia is a small country with a small population. Therefore applying programmes and practices from other countries will always entail adjustment to local circumstances in which smallness is an influential factor. Specialisation, for example, is generally problematic in smaller countries. A move towards a more generalist approach will be necessary. A way to do this in Estonia is to address the gap between the health and social care sectors by standardising knowledge and skills across the sectors. Standardisation of skills and knowledge as a co-ordinating mechanism is the most appropriate mechanism for co-ordination in organisations with complex tasks that require considerable knowledge for assessments and decision making aimed to solve unique and multi-faceted problems. These co-ordinating mechanisms are certainly in place already via social workers in the social care sector, and general practitioners or family doctors in the healthcare sector.

These two professions are the main gatekeepers of services within each system and thus key players in the co-ordination of services. However, if the standardisation of skills and knowledge only applies to each group inside each sector, *e.g.*, social workers inside the social sector and general practitioners inside the healthcare sector, the co-ordinating mechanisms may work well within each sector, but it may create or even amplify the problems of co-ordination across sectors.

To address this divide, standardisation of skills and knowledge across the sectors of health and social care needs to draw on knowledge and evidence based on the science of ageing from which these professionals can draw lessons and apply common understanding about their client group. In doing so, the two sectors providing services to the same group of clients gain a common ground. In effect, standardisation of skills and knowledge is, in this context, a "market-based approach" since it focuses on the clients as a group of users for which these two sectors are producing services, in order to determine how collectively they could work in the users' interests in assessing and meeting their needs. This recommendation addresses the gap between health and social care and supports a more user-driven approach to the provision of long-term care.

Investing in knowledge and skills now would help the health and social care sectors to take positive actions, such as recruiting and building up a stock of qualified case managers who, guided by collective standardised needs assessment and individual care plans, perform a critical role in co-ordinating services and in maximising the use of existing resources and services before turning to permanent institutional care. A more holistic understanding of users based on a better knowledge of ageing needs not only promotes co-operation, but leads to more user-focused and therefore better tailored and integrated services. Case managers operate in teams both at the interface of care in the community and the interface of acute care hospitals and long-term care. Well-trained and skilled case managers and standardised needs assessment are the most powerful "instruments" to implement in order to deliver good results with limited means. The model of "case management" is already fairly widespread across Europe in the social care sector and it has been identified by the so-called PROCARE teams as models of co-ordination which can vary even within a country. Case managers are usually social workers or nurses and their main tasks vary depending on where they are located in the health and social care systems. They manage the information flow, take care of all co-ordination practices, map the users' social network or support systems, and counsel users and their families, among other tasks. In terms of information and guidance, the case managers constitute "a one-stop-shop" from the point of view of the user.

In order to develop a user-centric vision and knowledge of the elderly and their needs, the Estonian government should plan to establish a gerontological research institute at one of the universities and start up post-graduate teaching in gerontology and geriatrics. A first step towards this goal could be to set up teaching programmes in gerontological studies for post-graduate students of social work, nursing, physiotherapists, as well as training courses for care staff and geriatric courses for medical doctors at one of the universities in Estonia. Knowledge and insight drawn from gerontological and geriatric research[8] would create collective values and common conceptual frameworks across these two sectors. With this new input, the government would raise the level of capabilities and analytic capacity inside both sectors and generate a professional partnership across these areas. This would be a major contribution to professional development and improve the recruitment of professionals equipped with appropriate skills and knowledge to work in the field of

elderly care and manage the complex processes at the interface of health and social care. The neighbouring Nordic countries have ample experience and knowledge drawn from gerontological and geriatric research and development and may be able and prepared to contribute to this type of project and service development in Estonia.

Gerontological and geriatric research into the living conditions of elderly Estonians will create a better understanding of the determinant of good health and well-being amongst elderly Estonians. It will shed light on the health and social issues which may characterise the Estonian elderly population and thus produce unique knowledge to be applied to policy. This type of knowledge is critical for good governance in the field of health and social care since performance indicators based on evidence from the Estonian population provide a basis for performance measurement and policy development.

It is important to highlight that creating a collection of standardised needs assessment and data on quality of care must be based on educational programmes for staff and training in the use of common conceptual frameworks. The reliability of this data collection rests on standardisation of skills as well as processes, and thus establishment of educational programmes for teaching and training of staff and promoting gerontological and geriatric research on data draw from local experiences.

Eliminate barriers and disincentives to more effective use of resources

As mentioned earlier, the EU member states are striving to ensure a sustainable mix of public and private sources of finance to meet foreseen increases in demand for accessible, resource-efficient and high-quality long-term care. The PROCARE project identified and examined integrated ways of working in nine European countries. It found that due to fragmentation of health and social care services in most European countries, the level of integration of services into a vertically integrated decision-making authority described in the literature as a "consolidated direct service model" was rare. Only one such model was analysed and it demonstrated that, apart from positive framework conditions that invest in innovative approaches, long-term funding and organisational development are necessary to achieve a sustainable impact (see Box 8.3).

The model used in the small Danish Municipality of Skævinge, as described in Box 8.2, "seems to be dependent on special circumstances that include explicit long-term care policies at the national level, co-ordinated strategies on regional and district levels, and a clear determination on the local policy level. Furthermore, 'bridge builders' and 'pioneers' have been able to introduce a change process based on leadership, dialogue and communication, rather than on professional hierarchies and narrow-mindedness." (Billings *et al.*, 2005).

A good starting point for considering how to revise the financing of services for the elderly in Estonia is laid out in the June 2009 report of the AS PricewaterhouseCoopers Advisors' (PriceWaterhouseCoopers, 2009). It fleshed out and defined six options for the improvement of the Estonian financing model for long-term care. However, it said little for any of the options about a comprehensive assessment of needs, and thus about the possibility of grouping needs into categories and activities on which to base definitions and costing of care packages. That said, the report does provide a useful overview of the financing models which need to be considered. Another report, *Responding to the challenge of financial sustainability in Estonia's health system*, was published in 2010 (Thomson *et al.*, 2010). This report recommends broadening the public revenue base, in particular with regard to older people. While some stakeholders in Estonia feel that ensuring that those who benefit from EHIF coverage contribute to its costs

Box 8.2. **Vertically integrated decision-making authority in Denmark**

In the small Danish municipality of Skævinge, authorities have invested in Health Centre Bauneparken since 1984, achieving positive outcomes. The centre provides integrated health and social/personal care on a 24-hour basis irrespective of the user's housing status. This is carried out by 136 professionals (FTE) from 13 different professional groups employed by the municipality. The Health Centre constitutes a single point of contact for potential users in the municipality. A variety of services for those who need them are co-ordinated by a case manager and the staff applies the concept of a preventative approach entitled "Self-care".

The number of older people has increased significantly over the past 20 years; however, operational expenditures have decreased over the period due to the preventative focus of the integrated care scheme. There is no waiting time for apartments in the Health Centre or for domestic health and social care services; the preventative efforts have resulted in a surplus of capacity that has been used mainly to establish an intermediate care facility at the Health Centre in order to prevent unnecessary hospital admissions. Consequently, the number of days in hospitals has been reduced by 30-40% for all citizens in the municipality. Over the last 10 years, no citizen from the municipality staying in a hospital has had to wait for discharge after having finished treatment, as those citizens are cared for either in the intermediate care facility at the Health Centre or in the citizen's own home. The municipality's use of, and expenditure for, national health insurance is below the average of all other municipalities in its county.

Source: Billings, J. and K. Leichsenring (eds.) (2005), "Integrating Health and Social Care Services for Older Persons. Evidence from Nine European Countries", *Public Policy and Social Welfare*, Vol. 31, Aldershot (UK): Ashgate/European Centre.

Box 8.3. **Finland: Integrated home care for elderly people living at home in Helsinki and Espoo**

The Finnish municipalities of Helsinki and Espoo do both horizontal integration (integrated assessment, care planning and provision/evaluation case management), and partial vertical integration (the hospital-home care interface). The first visit at the older person's home is always by a multi-professional team, involving co-operation between home-help and home nursing services. If necessary, the hospital discharge nurse and a physiotherapist are also involved. The model is publicly organised and financed. Municipalities in Finland finance their services with tax revenues (70%), state subsidies (20%) and client fees (10%). In this area, more than 10% of older persons above 75 receive permanent home care.

Source: Billings, J. and K. Leichsenring (eds.) (2005), "Integrating Health and Social Care Services for Older Persons. Evidence from Nine European Countries", *Public Policy and Social Welfare*, Vol. 31, Aldershot (UK): Ashgate/European Centre.

– particularly older people – would enhance public perception of health system fairness, the report argues that the central government should recognise that many older people have either already contributed to EHIF while working or would not be financially able to contribute due to the low pensions in Estonia. Therefore, the government should make contributions to EHIF on behalf of pensioners (Thomson *et al.*, 2010).

As these reports make clear, the government is at a crossroads where major decisions about policy direction cannot be avoided. This is true, especially because the population is ageing rapidly and because the economy will take some years to recover from the global

financial and economic crisis. The big question is whether to meet these challenges through marginal improvements in the existing "two care systems" (healthcare and social care systems operating independent of each other) or whether to develop a model of long-term care in which a continuum of care for the elderly is systematically co-ordinated *towards* integrated health and social care provision based on individual assessment of need. The most realistic option for Estonia may be a move *towards* integration, but not a full integration of the health and social care sectors. This is a step-by-step approach in which professionals and care staff in the two sectors are brought closer together through the standardisation of skills and knowledge and also in co-operative settings in the community. Making marginal improvement is hardly an option, because that will leave Estonia with a fragmented care system dealing with the delivery of long-term care, high cost of co-ordination, inefficient use of scarce resources, lost opportunities to create a critical mass of care workers at local levels, to build multi-professional expertise in centres of excellence and to exploit economy of scale at every turn. To avoid further fragmentation of the care systems, it is critical that the government makes a holistic review of the options as suggested in the first recommendation.

Given the momentous issues currently at stake, the government's first step could be to set up a working party of experts and representatives from the main service purchasing authorities and other stakeholders, *e.g.,* the EHIF, local governments, social insurance board, and user organisations. This working group would have the remit to debate, discuss and develop options for: *a)* a mixed financing of long-term care; and *b)* a move towards delivery of health and social care for the elderly. The reports referred to above provide ample material which needs to be considered and debated among stakeholders in order to guide the way forward. Activity-based costing and the principle "money-follows-the-patient" as a means to develop client-centred services in both the health and social care sectors should be considered. It is also important to design incentives which encourage the exhaustion of lowest levels of care before taking up more expensive care. As mentioned, this working party should bring in technical expertise to develop options regarding how to create more diversified streams of financing in order to make long-term care less dependent on local government budgets and users' co-payments. The key is to match the financial restructuring of health and social care services to the white paper vision selected by the Estonian government so that one is supportive of the other, promoting a move in the desired direction.

Given the comprehensiveness of services included when creating a system of integrated health and social care, shared funding is inevitable – as opposed to the current separate budgets for healthcare and social care, which produce waste on account of the lack of co-ordination based on assessed needs. Shared or pooled funding, *e.g.,* pooling resources across EHIF, state, local governments and the individual/family, requires resource flexibility and readiness to change priorities, collective commitment and partnership across levels of government and across sectors. Shared or pooled funding does not mean a creation of yet another agency or insurance fund; rather it is referred to here as the co-ordination of multiple streams of financing. In order to avoid the pitfalls of fragmentation and to ensure a user-friendly "one-stop-shop" kind of processing of users' entitlements to coverage and or co-payments, multiple sources of financing require sophisticated back-office operations.

Here the experience and skills acquired in the EHIF can be a valuable resource. EHIF has made significant efforts to manage its resources, to develop skills in strategic purchasing and to operate transparently. Moreover, it has also tried to be responsive to

patients' needs and demonstrated willingness to be held to account (Thomson *et al.*, 2010). These practices can be an asset in developing an approach towards an integrated long-term care system and activity-based financing of services.

Multiple streams of financing give better scope to put the necessary incentives in place in support of a comprehensive long-term care policy. It may, for example, help make the most efficient use of each level of care before moving up towards more expensive levels of care. A common frame of reference when defining the basis for multiple streams of financing in long-term care is to refer to three main sources of financing: *a)* the users of care; *b)* local governments; and *c)* the state taxes or health insurance funds. These three/four sources of financing of long-term care entail different incentives and different means of avoiding "cost dumping" by local governments – shifting the cost of social care on to hospitals or other healthcare institutions and away from themselves. Table 8.4 illustrates the basic idea behind this type of mixed stream of financing in which the principle is that of money-follows-the-patient:

Table 8.4. **An illustration of mixed funding based on the principle of individual rights and responsibilities and "money-follows-the-patient"**

Services	Living in the community	Living in an institution, whether institutional social care or a long-term nursing care hospital
Housing, electricity, heating, food, clothes, other ordinary costs of daily living, the so-called "hotel cost"	The user	The user
Meals-on-wheels, transport, home help (shopping, preparing meals, cleaning and other social care at home), recreational activities in activity centres	Local governments with user co-payments	Local governments continue to fund its share and the user its share, just as when the users lived independently in the community
Personal hygiene, assisting with eating, etc.	Local government and the user who gets disability allowance from the Social Insurance Board in case of moderate, severe or profound disability	Local government and the user who gets disability allowance from the Social Insurance Board in case of moderate, severe or profound disability
Nursing care, looking after medication, medical aid equipment necessary to provide a complete nursing care, physiotherapy, occupational therapist, speech therapy	The Estonian Health Insurance Fund	The Estonian Health Insurance Fund
Medication, pharmaceutical drug by prescription of a medical doctor	The Estonian Health Insurance Fund and user co-payments in line with existing rules	The Estonian Health Insurance Fund and user co-payments in line with existing rules
Medical care, diagnostic services and treatments	The Estonian Health Insurance Fund and user co-payments in line with existing rules	The Estonian Health Insurance Fund and user co-payments in line with existing rules

The starting point for the principle of shared or multiple streams of financing is the idea of a set of basic responsibilities for individuals and governments, and the linked idea of individuals' entitlements to public help. The users of care are responsible for covering the basic costs of housing, electricity, heating and food. This is often referred to as "the hotel cost" when living in institutional care. This makes up the first funding stream. If an individual is unable to cope with daily living at home, the person in need for help in the house is entitled to social services such as home help and personal social care provided by local government. This entitlement should follow individuals as long as they live within the local government's borders or are moved to an institution as a part of a care package decided upon in partnership with local governments' social services. This entitlement creates the second funding stream. As long as this is a part of the Social Welfare Act, local governments cannot avoid this responsibility. The third funding stream is for health and medical care services, and the source may be the central government (out of the general taxation or out of earmarked taxes, the entitlement being based simply on citizenship) or the funding may come from a health insurance fund, as is the case in Estonia.

The key problem to avoid is that – absent regulation regarding financing and provision of services – local governments, in the context of fragmented care systems, have incentives to keep the level of services in the community at a low level and, by doing so, create pressure on institutional care – in which the costs of care is shared either between local governments and the user, or paid for by the central government or by insurance funds. That is, local governments have incentives to shift the costs of care either to the user or dump the costs of social care on to healthcare institutional care paid for by somebody else. As shown earlier, the cost of care has increasingly shifted to users – already an economically weak group in Estonia – and their families. A more equitable cost sharing is necessary in order to keep their co-payments manageable, in particular for those the least able to pay. Providing users with more information and a voice would help to balance municipal economic interests and provide the state with a rational for improving the co-ordination of financing of health and social care.

Establish a more consistent and coherent needs assessment instrument

In the context of a system of care which consists of many different providers and purchasers, a standard aged care assessment programme is crucial. Standardised needs assessment schemes are necessary in making decisions about planning and allocation of services. Hence, it is about management of resources. In effect, implementing standardised needs assessment or common evaluation criteria involves a mix of standardisation of work processes and standardisation of work outputs since it stipulates certain procedures to perform in order to justify a decision on care delivery and defines the needs that must be met, to which level of care and to which standard of quality, *i.e.,* it guides the process of matching care to needs. It provides the authorities with an instrument to improve information on the care provider market and thus builds up a responsive system of care which is based on needs assessment, *i.e.,* is "user driven" as opposed to "provider driven", so that needs determine supply. It is also an instrument to monitor quality of care and form a basis for activity-based financing of care. At the aggregated level, standardised needs assessment serves as a measurement of the level of needs for institutional care in a given region and may provide information about the degree of urgency of needs. Hence, standardised needs assessment is the instrument which provides central authorities with comparable information about waiting lists for a given type of service or care in a given region. Such an assessment is produced by a professional body, an Age Care Assessment Team or Geriatric Assessment teams working on behalf of the elderly person, independent of purchasers and providers in the system.

Standardised needs assessment is under development in Estonia. There are seven Geriatric Assessment teams operating in regional and central hospitals in Estonia and they apply the Resident Assessment Instrument (RAI) adapted from Finland (Nord-RAI) for long-term care. RAI Home Care has a built-in composite measure addressing changes in health, end-stage disease, and symptoms and signs of medical problems. It is a strong predictor of mortality. This measure, the CHESS score (Changes in Health, End-stage disease and Symptoms and Signs), provides a useful new minimum data set-based test to predict mortality and to measure instability in health as a clinical outcome. As such, it has made RAI Home Care useful as a pre-admission screening instrument. RAI Home Care has also been tested and adapted to Estonian circumstances since 2004. Members of geriatric teams are medical doctors, nurses and social workers and these geriatric teams operate in

the regional hospitals and central hospitals. Two of the regional hospitals serve an area with a population of approximately 500 000 and the central hospitals serve an area population of approximately 200 000.

This is an important development. There are many advantages involved in adapting the Nordic version to Estonian circumstances. This instrument has been tested and developed over a number of years in the Nordic countries and the long-established practices of knowledge sharing and policy transfer across the Nordic and the Baltic countries could be an invaluable vehicle for policy learning for the Estonians. The government should support the process of implementing the RAI programme as a nation-wide scheme by setting up a national steering group with experts from both the health and the social care sectors representing front-line staff from all three levels of government: state, regions/counties and local governments (see reference to the Finish experience).

The advantage of the RAI instrument is that it can serve as a step towards activity-based costing of care in institutional settings. A sub-unit of this instrument, so-called Resource Utility Groups (RUGs) is a tool used to finance the services of activity-based costing. Moreover, the RAI instrument as an international instrument standardised to national circumstances enables definition of national outcomes and performance indicators and facilitates both cross-county and cross-country comparison, which can inform questions of clinical, managerial and financial importance. Iceland and Finland are probably the countries in Europe which have the most advanced implementation of this instrument. In Iceland, the funding of institutional care for the elderly has been based on RUGs since 2003.

However, implementing the RAI programme and using the RAI form is seen by some as very complicated and time consuming. A critical component for the RAI programme to work is that it needs to be applied consistently and comprehensively across Estonia and that the working process and the information gathering should be computerised. An assessment of the Inter-RAI system in Tartu County found that the system was useful and should be adopted more widely, but it was also perceived by users as being complicated. The introduction of the RAI programme will need to be accompanied by resources for training on the use of the system, as well as its longer-term benefits for social care staff, users, and the system as a whole. In some cases, additional resources may also be necessary for the additional administrative requirements of using the system, in particular for small jurisdictions.

Information technology is a critical component of a successful implementation of the scheme and as a tool to improve communication between professionals within, as well as across, sectors. Therefore, while developing the scheme the government may, as a first step, consider another simpler computerised version of standardised needs assessment in Estonia and thus with the help of information technology build a bridge between professionals in the sectors and improved information and thus decision making in the process of matching care to needs. This is what happened in Iceland in the early 1990s. A home-made computerised standardised pre-admission (needs assessment programme carried out to assess the needs for institutional care prior to admission) scheme had been implemented before the RAI was introduced in the mid 1990s.

Box 8.4. **The access problem: One-stop-shops, multi-dimensional assessment and guidance in Iceland and France**

In 1982, the *Act on Elderly Care* was introduced in Iceland. It introduced a continuum of care, a chain of services designed the meet different levels of care needs, and a poll tax to invest in building appropriate facilities to provide a variety of services. In the early 1990s, the government, assisted by national regulation passed in Parliament, implemented a pre-admission scheme as a screening device in order to assist decision making on two levels: *a)* allocation of places in existing residential and nursing homes to elderly individuals in need of this level of care; and *b)* allocation of funds to local governments to invest in care facilities, and thus regional planning of care services. In the mid 1990s, the government, again supported by national regulation passed in Parliament, implemented the RAI programme (Residents Assessment Instrument), and adapted the NordRAI version to Icelandic conditions. By 2003, this programme had been further developed and was launched as a base for funding institutional care, *i.e.,* the RUGs (Resource Utility Groups). Since the introduction of the first pre-admission scheme and later the nationally standardised age care assessment programme, the need for care has changed the pattern of service demand. Previously, the bulk of institutional beds were in residential homes (social care homes). Now, residential homes have by and large been replaced by purpose-built sheltered apartments for the elderly. The elderly either purchase the apartments, or they enter a scheme of a mix of purchased-rented apartments or fully rented apartments, sometimes attached to a social and service centre offering different levels of services on site and access to local services. At the other end of the service chain are the nursing home beds where people move to spend the last months of their lives receiving integrated health and social care in a "home-like" institution. The residential care is gradually being phased out. As the services in the community have been expanding and the assessment programme has become more sophisticated as a screening instrument, the length of stay in nursing homes has been shortening, because older people stay longer in the community and move at later stage into nursing homes. In Iceland, there is a mix of care providers, *i.e.,* NGOs and public and private organisations build and provide services such as security, sheltered or service apartments, as well as nursing homes. There is a single point of access to nursing homes based on this comprehensive national age care assessment programme carried out by regional geriatric assessment teams.

Another example of systems that reduce information and access problems was identified in the PROCARE project. The "Local Information and Gerontological Co-ordination Centres" (CLIC) in France. They inform, advise and support citizens by assessing their needs in multi-professional teams. Following this procedure they compile a personalised care plan for each person and monitor its implementation with relevant team members. Even those CLICs that are not providing hands-on services have shown that, with a small and dedicated team, they are able to create a "gerontological culture" in a given area, facilitating the continuity of care services in the community and serving as mediators between clients, providers and professionals.

Source: Leichsenring, K., G. Roth, M. Wolf and A. Sissouras (2005), "Moments of Truth. An Overview of Pathways to Integration and Better Quality in Long-Term Care", *in* Billings, J. and K. Leichsenring (eds.) (2005), "Integrating Health and Social Care Services for Older Persons. Evidence from Nine European Countries", *Public Policy and Social Welfare*, Vol. 31, Aldershot (UK), Ashgate/European Centre.

Define desired outcomes: Performance indicators and service specifications

The European Union is promoting the co-ordination of national long-term care policies through the Open Method of Co-ordination with a particular focus on access,

quality and sustainability (European Commission, 2010). As discussed in the section on international policy context, the Open Methods of Co-ordination and current process of co-operation in the field of health and long-term care are brought together under common objectives and simplified reporting procedures. This approach of Open Method of Co-ordination is meant to help member states to design and implement their own policies; it is designed to put pressure on member states to bring up the standards of services in line with common European objectives.

Every country needs to develop its own outcome and performance indicators based on evidence from research carried out within its own population. Evidence from cross-country research in the field of elderly care in 11 European sites show great differences in the incidences of diseases, marked differences in functional status and characteristics of users and patterns of service utilisation and use of medication. The findings are said to have implications for the delivery of home care in cities where the studies were conducted (Sørbye *et al.*, 2009). [See also accounts on the use of different frameworks for quality of care assurance in long-term care in European countries in Eurohealth (Eurohealth, 2010).]

The first step for the Estonians is to build up evidence-based knowledge about their own elderly population. They must better understand the features which characterise this age group in Estonia and to what extent, how and why they are different from their peer groups in neighbouring countries. Tables 8.1 and 8.2 (see section "The Estonian Context") on retired people with long-standing illness or health problems, and figures on self-perceived limitation in daily activities among retired people compiled by Eurostat and discussed in earlier bring out a striking picture. Only in few cases, highlighted in the Tables, are there countries where the figures are higher than those in Estonia. Research may inform the design of programmes addressing the problems behind these figures, develop preventative measures and thereby reduce costs in the long run. One typical question in this respect is the rate of falls and hip-replacements among elderly in Estonia and how the rate in Estonia compares to the rate of falls and hip-replacements in other countries. What national differences might explain the differences in rates? And what can be done to reduce the rate of falls among the elderly? Another question may be whether and to what extent the level of use of psychotropic medications in institutional care varies among institutions or changes over time, and what may explain the variation or the changes.

Research into local circumstances is crucial in order to enable both in-country as well as cross-country comparison. Research can inform the process by which policy outcomes are defined and can help to develop performance indicators. Research evidence which draws on local data is an important instrument in the process of improving information for providers of care and thus improving the process of matching care to needs. But it also requires close collaboration with providers, since standardised collection of information requires participation of all providers of institutional care for the elderly.

While the Nursing Care Master Plan 2015 prepared by the Ministry of Social Affairs in 2001 had set out a target for nursing care beds at a minimum of 10 per 1 000 of the target group, *i.e.,* about 2 100 beds in total (Koppel *et al.*, 2008), this paper warns against setting targets of this kind in the absence of a standardised national needs assessment scheme. It is a dangerous policy which builds on estimates drawn from standards abroad when: *a)* domestic research evidence are limited; and *b)* standardised needs assessment is not consistently and comprehensively implemented. Management by targets has been criticised for creating perverse incentives resulting in a well-known and a frequently

referred to phrase of "hitting the target but missing the point" (Bevan and Hood, 2006). In the absence of sound local information and needs assessment, programme management by targets leads to a more provider-driven development of service supply, opportunistic behaviour and inefficient use of limited resources.

Conclusions

The Government of Estonia is at a crossroads where major decisions about policy direction cannot be avoided. The country faces many economic and social challenges, including the current economic recession and the rapidly ageing population and shrinking workforce. The impact of the recession on the Estonian economy may temporarily overshadow the challenge of the demographic factor, but the economic recession may amplify an issue of major concern, *i.e.,* differences in access to social services across cities, towns and rural municipalities in the country, and thus increased geographic inequality. Moreover, the impact of the recession on families and family relations may lead to breakdowns of the traditional inter-generational support and reduce capacity to provide help or contribute financially to organised care services for elderly family members.

Local governments in Estonia have the responsibility to ensure access to social services for their local citizens. This case study argues that ensuring equal access to an appropriate level of care services for the elderly across Estonia will require more than just re-organising social services at the local level. In Estonia as elsewhere in Europe, it will take no less than a concerted integrated approach in which the funding and delivery of health and social care at the interface of services in the community and at the interface of acute hospital care and long-term institutional care will have to be reformed. In the Estonian context, this means taking a single government approach by putting in place common frameworks for assessing quality and service needs, and comparing and aggregating data in order to better understand and respond to elderly needs. This, in turn, will put the incentives in place for a more integrated care market and improved co-ordination across municipalities and sectors.

A whole-of-government approach. In Estonia, nationally standardised comprehensive needs assessment is missing. Lack of comparable data on service needs constitutes imperfect information to which the care provider sector in Estonia is responding. Nationally, the provider sector's response is likely to result in inefficient use of scarce resources, because the link between actual needs and the type and level of services provided is ambiguous. Therefore, whether the right level and type of needs are being prioritised and thus met at the right time, and at the right place, is difficult to determine.

In circumstances in which providers of services play multiple roles – *i.e.,* they assess the needs for services locally, ensure funding and make individual decisions on service delivery – the providers may be tempted to give priority to services in which users' co-payments are higher or in which local governments' organisational and administrative costs can be minimised. This provider-driven behaviour is made possible in the absence of good information which otherwise would put pressure on local governments to better match care to needs. Nationally, a standardised needs assessment programme is a regulatory instrument which provides comparable measures to ensure that equal needs get equal treatments and thus to improve geographic equality based on a more user-focused services.

Furthermore, an unregulated social care market in which the links between care needs, prices and quality of care is undefined and ambiguous may, due to imperfect

information, creates distrust and causes local government officials to refrain from referring users to private providers. In effect, this constitutes barriers to market entry. On the other hand, in the case where local governments, which most often are the dominant provider of care services themselves, were to become the regulators of privately provided care services within their jurisdiction, the possibility of conflicts of interest is obvious.

Since geographic inequality in terms of access to services is a matter of concern, a comprehensive, nationally standardised, need-based approach puts the emphasis on users' needs for making individual decisions about the type and level of services to be provided. At the aggregated level, such a comprehensive needs assessment will translate into a demand to which "the provider market", whether public or private, can respond more efficiently. Here the state has to step in and the role of central government should be to improve information on the "care market" in order to facilitate the process of matching care to needs, protect the rights of the users and thus avoid local government failure as well as market failure to happen.

A common agenda. This case study has found a deep divide between the health and social care systems in Estonia. This divide means that the country has, in effect, two care systems with different sources of financing, different groups of professionals, different sets of organisational norms and culture and different social status and prestige (with the social care being the subordinate system). For a change of policy to take place, the government needs to create a strategic vision to guide the formulation and implementation of a long-term care policy, and make a collective commitment to see this long-term policy through. To start this up, it could be useful to begin a national dialogue on aspirations for elderly care. This could include having a professional organiser from outside Estonia to prepare, inspire and organise an event which could attract experts, investors, business and NGOs who might be interested to join into programmes and project development in Estonia.

The Estonian government should steer the problem of geographic inequality of access to social care services for the elderly at local levels into a process of mutual adjustment between levels of government, using national policy instruments. In this process, stakeholders at all levels – local, county and state levels, user groups, care providers, public, private and NGOs – should be mobilised and entrusted with the task of creating the vision on which to base a national long-term care policy.

The absence of instruments to co-ordinate the health and social care systems so as to assure continuity of care and more efficient use of resources makes piece-meal improvements difficult. In this effort, evidence from other European countries shows that national regulations are needed to help develop regional and local service structures (Billings *et al*., 2005) (see Box 8.5).

Delivering public services. Local governments have the responsibility to respond to service needs and to ensure access to social services for the elderly. This responsibility requires appropriate skills and expertise to assess the needs of elderly people and therefore determine the type and level of demand. Matching care to needs in order to maximise the most efficient use of resources requires administrative capacity to process the relevant information and to contract to the relevant providers of services and/or organisational capacity to provide the services within the local governments' system of care services. These professional capacities and capabilities are currently missing in most local governments in Estonia.

Box 8.5. **National regulations help develop regional and local service structures**

In **Finland**, **France** and **Greece**, legal regulations were introduced on a national level to co-ordinate and/or integrate home care services. This pattern can be observed in most countries – national regulations help develop regional and local service structures, presumably due to the fact that local policies are too weak to introduce this kind of innovation. In **Italy**, a "Working Unit of Continuous Care" in the Province of Vicenza and a "Single Point of Access to Home Care" in Empoli, Tuscany Region, are two models which were made possible because of an initiative taken by healthcare staff, and also because the Italian national legislation provides guidelines for integrated health and social care that have to be implemented by the regional governments in co-operation with various other stakeholders.

Source: Leichsenring, K., G. Roth, M. Wolf, and A. Sissouras (2005), "Moments of Truth. An Overview of Pathways to Integration and Better Quality in Long-Term Care", *in* Billings, J. and K. Leichsenring (eds.) (2005), "Integrating Health and Social Care Services for Older Persons. Evidence from Nine European Countries", *Public Policy and Social Welfare*, Vol. 31, Aldershot (UK), Ashgate/European Centre.

Due to the small size of most local governments in Estonia, and thus problems related to economies of scale, the programme of comprehensive standardised needs assessment may need to be developed, administrated and co-ordinated at the county level, while a "care market" could be developed at a wider level, for example through multi-county co-operation. Local governments would still have the responsibility to ensure access to services either by direct provision or contracting out to other public foundations or private providers.

This case study makes the case for a clear role for the central government in assisting sub-national governments by building capabilities at sub-national levels. It can help by providing: *a)* appropriate skills and training; *b)* the necessary instruments to guide decision making; and *c)* funding. With respect to funding, the central government should develop a financing scheme in which financing of comprehensive, integrated long-term care would be diversified. A multiple stream of financing in which money-follows-the-user is more likely to eliminate perverse incentives and to provide the right type and level of care at the right time. Also, the government should consider a new source of financing, such as a temporary earmarked tax in order stimulate development and build up appropriate facilities and/or re-develop the existing stock of facilities to bring them up to today's standards.

This case study has deliberately avoided bringing in standards, indicators and benchmarks from abroad to directly inform policy for the Estonians. In the absence of standardised national needs assessment, it does not make sense to set targets for the number of nursing beds or institutional care beds per 100 000 population, or other such targets pulled from an average of international experience. Management by such targets in the absence of good information stimulates a more provider-driven approach and can easily lead to over-investments and divert financial resources into areas which may not be top priorities in Estonia and which, once allocated, cannot readily be switched to other uses.

Expenditure on healthcare is lowest in Estonia compared to all the European OECD countries. It seems obvious that Estonia needs to spend more on healthcare in order to improve health outcomes. The same can be said about expenditure on social care. But the question remains: how much more Estonia needs to spend to reach similar health outcomes as other European countries? Before answering this question, it is more relevant and more pressing right now to answer these questions: What can Estonians do now, and

in the near future, to make better use of the overall resources spent on health and social care? How should the Estonians go about doing what needs to be done? The economic crisis will limit resources for additional spending in the near future, but that does not prevent Estonia from establishing a framework now for improving services, including when resumed growth allows further increases in social and health spending.

This case study has focused on immediate steps that could be taken to bridge gaps between service and skill communities, across funding and assessment mechanisms, and across governments, both horizontally and vertically. Only by working as a single government can Estonia hope to make better use of resources already being spent, make services more user-and needs-focused, and chart a common path for improving care of its most fragile citizens.

Notes

1. Health Status, the rates of life expectancy, infant mortality and causes of death from cancer and diseases of the circulatory system in 2007.
2. GDP per capita, USD PPP in 2007.
3. Total expenditure on health, USD 2 000 per capita PPP in 2007.
4. Total expenditure on social protection per head of population. ECU/EUR at *http://epp.eurostat.ec.europa.eu/portal/page/portal/social_protection/data/main_tables*.
5. It should be noted here that in the 2008 figures Eurostat builds partly on the 2007 administrative data.
6. Estonia has 33 cities and 193 rural municipalities. These designations are historically based and do not indicate the level of population density, or remoteness *versus* closeness to services, etc.
7. Social protection services are social welfare institutions for the elderly and other social protection for the elderly in the form of financial benefits and benefits in kind to protect against risks related to old age. In all the data on social services examined here, the focus is on services for the elderly only. The 2009 figures on local government expenditure on social protection in Estonia show that about 72% of the total went to social protection for the elderly. Focusing on these figures alone gives the analysis a better strategic significance, since ageing of the population can be foreseen and thus planned for, but that's less the case when analysing expenditure on services for the disabled – although there are some overlaps.
8. The term "Gerontology" as applied here should be understood as the science of ageing, primarily engaged with the comprehensive study of the ageing process and various problems or incidents associated with ageing and the aged. It is concerned with the ageing process as a life-cycle phenomenon involving biological, psychological, social and economic processes. Therefore, "gerontology" is a multidisciplinary approach to the study of the ageing process. Most importantly, in "gerontology" the process of ageing is understood as a healthy normal process of getting older. On the other hand, the term "geriatric" is a branch of medicine that deals with the problems and diseases of old age and ageing people.

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ANNEX A

Overview of Accrual Accounting and Budgeting Practices in Individual Countries

Table A.1. **Accounting basis applied to budget approved by legislator**

As of March 2009

	Full accrual basis	Accrual basis, except no capitalisation or depreciation of assets	Cash basis, except certain transactions on accrual basis	Full cash basis
Australia	X			
Austria				X
Belgium				X
Canada		X[1]		
Czech Republic				X
Denmark			X[2]	
Finland		X		
France				X
Germany				X
Greece				X
Hungary				X
Iceland		X		
Ireland				X
Italy		X[3]		
Japan				X
Korea				X
Luxembourg				X
Mexico				X
Netherlands				X
Norway				X
New Zealand	X			
Poland				X
Portugal				X
Spain				X[4]
Sweden				X
Switzerland	X			
Turkey				X
United Kingdom	X			
United States			X[5]	

1. Canada – Refers to the Estimates, the means by which appropriations are approved by the legislature.
2. Denmark – Interest expenses and employee pensions treated on accrual basis.
3. Italy – Budget prepared on both "full cash basis" and "accrual basis, except no capitalisation or depreciation of assets".
4. Spain – Modified cash basis: the Public General Accounting System takes the economic and legal environment of the public sector into consideration, which determines that the economic revenues and expenses deriving from budget execution must be recorded when correlative budgetary rights and obligations, that is, when the administrative act is dictated.
5. United States – Interest expenses, certain employee pension plans, and local and guarantee programmes treated on accrual basis.

Source: OECD (2009), "An Overview of Accrual Accounting and Budgeting Practices in Individual Countries", OECD Working Party of Senior Budget Officials – 9th Annual OECD Public Sector Accrual Symposium, 2-3 March, Paris.

Table A.2. **Accounting basis applied to consolidated (whole-of-government) financial statements**

As of March 2009

	Full accrual basis	Accrual basis, except no capitalisation or depreciation of assets	Cash basis, except certain transactions on accrual basis	Full cash basis
Australia	X			
Austria				X
Belgium			X[1]	
Canada	X			
Czech Republic				X
Denmark			X[2]	
Finland	X			
France	X			
Germany				X
Greece	X			
Hungary				X
Iceland		X		
Ireland				X
Italy		X[3]		
Japan				X
Korea				X
Luxembourg				X
Mexico				X
Netherlands				X
Norway				X
New Zealand	X			
Poland			X[4]	
Portugal				X
Spain	X[5]			X
Sweden	X			
Switzerland	X			
Turkey	X			
United Kingdom	X			
United States	X			

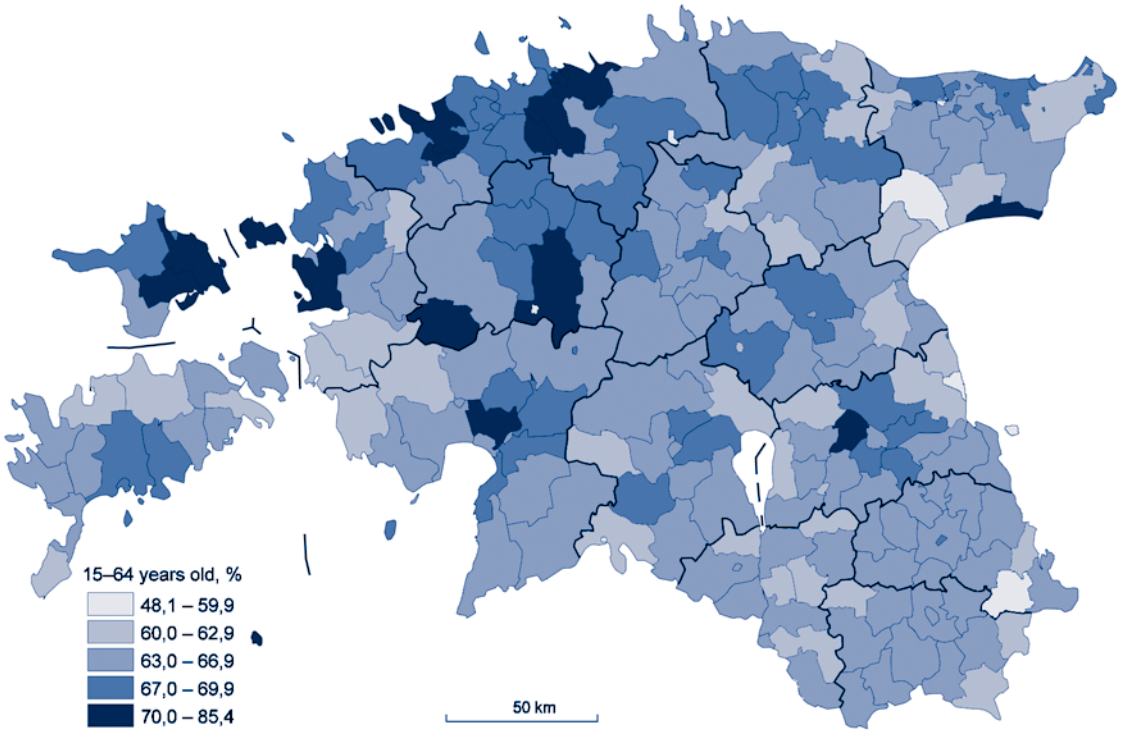
1. Belgium – Interest expense treated on accrual basis.
2. Denmark – Interest expense and employee pensions treated on accrual basis.
3. Italy – Statements prepared on both "full accrual basis" and "accrual, except no capitalisation or depreciation of assets".
4. Poland – Employee pensions treated on accrual basis.
5. Spain – Consolidation is being established gradually. Transactions between entities within the economic entity, including transfers and revenues recognised, are eliminated in full.

Source: OECD (2009), "An Overview of Accrual Accounting and Budgeting Practices in Individual Countries", OECD Working Party of Senior Budget Officials – 9th Annual OECD Public Sector Accrual Symposium, 2-3 March, Paris.

ANNEX B

Working Age Population Dispersion

Figure B.1. **Share of the working-age population by local government unit**
As of January 2010



Source: Statistics Estonia (2010), *Databases*.

ANNEX C

Management and Consultation

In March 2010, the Government of the Republic of Estonia commissioned a major review of the Estonian public administration, which was undertaken by the OECD. The objectives of this review were to examine how a single government approach could be fostered within the public administration in order to improve public service delivery and promote a better-performing government, which is forward looking and well prepared to meet current and future challenges.

A team of OECD staff members from the OECD's Public Governance and Territorial Development Directorate and consultants with sectoral expertise conducted the review. It was reviewed by the Public Governance Committee as well as national experts from a number of OECD countries.

As part of the data collection phase of the review, which took place between May and October 2010, the OECD conducted approximately 140 interviews and focus groups. These conversations were held with key stakeholders at the political and administrative levels, as well as representatives from civil society organisations and academics.

Table C.1. **OECD interviews: Political level**

Parliamentary Economic Affairs Committee
Parliamentary Finance Committee
Parliamentary State Budget Control Committee
Prime Minister's Office

Table C.2. **OECD interviews: State public administration**

Enterprise Estonia
Estonian Data Protection Inspectorate
Estonian Institute of Economic Research
Government Office
Ministry of Agriculture
Ministry of Culture
Ministry of Economy and Communication
Ministry of Education and Research
Ministry of Environment
Ministry of Finance
Ministry of Interior
Ministry of Justice
Ministry of Social Affairs
National Audit Office
Police and Border Guard Board
Statistics Estonia
Tax and Customs Administration

Table C.3. **OECD interviews: Sub-national level**

Haapsalu City Government
Haaskava Municipality
Harju County Development Centre
Harju County Municipal Union
Ida-Viru County Government
Jõhvi Municipality
Lääne County Government
Lääne County Municipal Union
Lääne-Viru County Government
Mäetaguse Municipality
Narva Municipality
Ridala Municipality
Tallinn City Government
Taebla Municipality
Tartu City Government
Tartu County Government
Tartu County Municipal Union
Tapa Municipality
Väike-Maarje Municipality
Viimsi Municipality
Viljandi City Government

Table C.4. **Other OECD interviews**

Archimedes Foundation
Association of Estonian Cities
Association of Estonian Rural Municipalities
Association of Teachers of Estonia
Bank of Estonia
eGovernance Academy
Environmental Investment Centre Foundation
Estonian Association of Gerontology and Geriatrics
Estonian Business School
Estonian Chamber of Agriculture and Commerce
Estonian Chamber of Commerce and Industry
Estonian Development Fund
Estonian Education Personnel Union
Estonian Employees Union Confederation
Estonian Employers Confederation
Estonian Nurses Union
Estonian Pensioners Association
Estonian Regional and Local Development Agency Finance, Ltd.
Estonian School Student Council Union
Estonian Trade Union Confederation
Geomedia
Gravitas Consult OÜ
Haapsalu College
Haapsalu Gymnasium
Haapsalu Social House
Haapsalu Vocational Education Centre
Institute of Sociology and Social Politics
Järva County Hospital
Jõhvi Care Hospital
Läthe Gymnasium
Mental Health Care Centre Foundation (Tartu)
Miina Härma Gymnasium
Network of Estonian Non-profit Organisations (NENO)
Open Estonia Foundation
Praxis Centre for Policy Studies
Tallinn University of Technology
Tartu University
Väike-Maarja Gymnasium

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Table of contents

Chapter 1. Main assessment and key recommendations

Chapter 2. The role of the state following economic success

Chapter 3. Public governance arrangements in Estonia

Chapter 4. Promoting a whole-of-government approach

Chapter 5. Building a common agenda

Chapter 6. Delivering public services effectively

Chapter 7. Case study one: Estonian education – sustaining high quality schools

Chapter 8. Case study two: Social services for the elderly in Estonia

Further reading

OECD Economic Surveys: Estonia 2011 (2011)

OECD Reviews of Labour Market and Social Policies: Estonia 2010 (2010)

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