# OECD *Multilingual Summaries*
# OECD Economic Surveys: Estonia 2019
*Summary in English*


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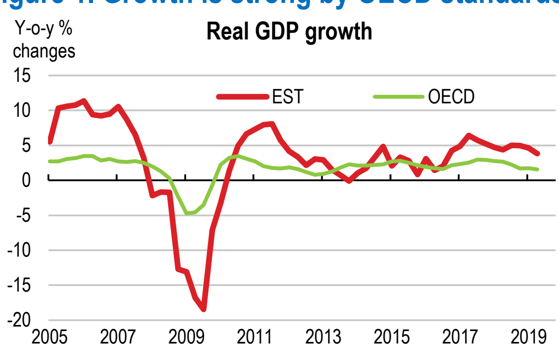
### Growth is strong, although slowing

*Estonia's economy continues to perform well, even though growth is slowing somewhat. Growth, however, could be more inclusive and there is room to boost spending in areas supporting long-term equitable growth.*

**Estonia has continued to enjoy a fast convergence**. However, many wellbeing challenges still need to be addressed: inequalities in income, health, environmental quality and other aspects of life, which vary across regions and by level of education, between genders and urban and rural areas. How to lift productivity by embracing digital technologies for stronger and more inclusive growth is the focus of this survey.

### Figure 1. Growth is strong by OECD standards




*Source*: OECD Analytical Database

**Growth will ease going forward**, moderating wages and inflation, as international demand softens and domestic pressures abate, notably in construction. The outlook is vulnerable to external events, including global trade tensions.

### Table 1. Economic growth remains strong

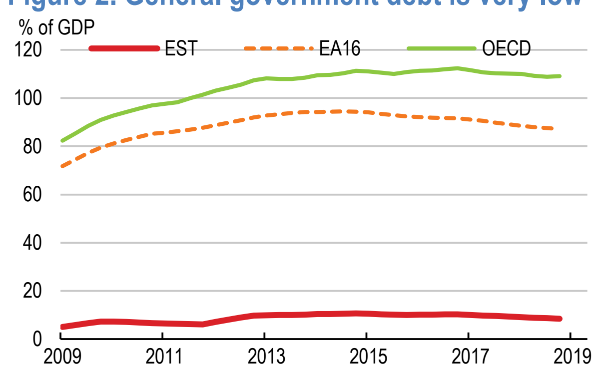
| (annual growth rate unless specified) | 2018 | 2019 | 2020 |
|---|---|---|---|
| GDP at market prices | 4.8 | 3.2 | 2.2 |
| Private consumption | 4.4 | 2.7 | 3.2 |
| Government consumption | 0.8 | 2.4 | 1.5 |
| Gross fixed capital formation | 0.9 | 14.1 | 1.7 |
| Exports of goods and services | 4.3 | 4 | 1.1 |
| Imports of goods and services | 5.7 | 3.8 | 2.2 |
| Unemployment rate (% of labour force) | 5.4 | 5 | 5.1 |
| Harmonised index of consumer prices | 3.4 | 2.4 | 2.3 |
| Current account balance (% of GDP) | 2 | 1.4 | 0.9 |
| General government financial balance (% of GDP) | -0.6 | -0.3 | -0.4 |

Source: OECD Economic Outlook 106 database.

**Fiscal policies have been mostly prudent, resulting in the lowest debt in the OECD.** In the recent upturn, fiscal policy has become pro-cyclical, which should be avoided. The free play of automatic stabilisers should be allowed and in case of a strong downturn, the exemption clause used. Extending the real estate tax base to residential real estate and higher environmental taxes and fees could partly finance long-term spending needs on infrastructure, health and social security and would provide room for cuts in labour and consumption taxes. Monetary policy will be supportive as growth is slowing.

**Proposed changes to the pension system pose risks.** The proposal to allow opt-out of the mandatory privately-managed second pillar of the pension system and early withdrawal of funds would boost government revenues, but may threaten macroeconomic stability and future pension adequacy. Moreover, impacts of the proposed changes have not been properly assessed. Withdrawal before retirement should not be allowed and pension funds should be more transparent about their costs and better governed to achieve greater efficiency and higher returns.

### Figure 2. General government debt is very low



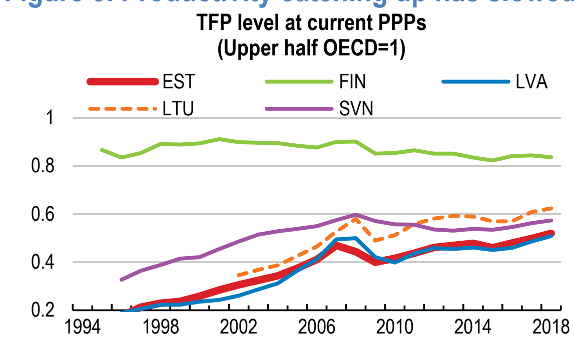

Source: OECD Analytical Database.

**Money laundering issues are being addressed**. The Financial Supervisory Authority (FSA) closed down Versobank and Danske Bank's Estonian Branch following earlier breaches of anti-money laundering rules. The FSA and financial sector cooperate to implement necessary checks and balances to prevent new incidences of money laundering. The government is addressing weaknesses of the legal framework to counter money laundering. This should include increasing fines to deterring levels and allowing the prosecutor to freeze assets on the suspicion of money laundering. Nordic-Baltic cooperation in banking supervision could be further improved.

### Growth needs to be driven more by productivity

*Estonia has adopted a business-friendly regulatory framework and is considering forefront* *regulatory tools for artificial intelligence. However, the productivity catch-up has slowed since the global financial crisis and the gap with top performers is large. Digitalisation of businesses provides a promising avenue to lift overall productivity. Further automation is key to boost competitiveness amid rising labour costs.*

## Figure 3. Productivity catching up has slowed




Source: OECD Economic Outlook 106 database.

**Estonia is a frontrunner in digitalising government services and boasts a number of native ICT unicorns.** The country should build on these key strengths to nurture digitalisation economy wide. Industry digitalisation policies should be holistic and reflected in government documents and their implementation monitored.

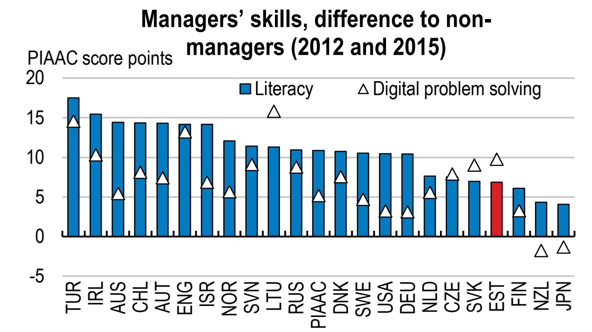
**Skills are key to boost the productivity gains from digital technologies.** High educational attainment and skills give solid foundations to make the most out of digitalisation. Almost half of Estonian jobs are at risk of automation or significant change. Ensuring high and up-to-date skills is central to seizing the productive potential from digital technologies and to sharing the gains equitably. Improving unemployment insurance coverage might give the unemployed with up-skilling needs stronger incentives to participate in training.

**Digital user skills are improving,** but quality of ICT teaching varies across compulsory schools, and many teachers feel unprepared. Adult education and training needs a boost, and employers should take more responsibility to train their employees.

**ICT activities for children should be designed to appeal equally to girls' and boys' interests** to boost the number of women ICT specialists. Overall supply of ICT specialists is catching up with demand, but employment is highly concentrated in the ICT sector. Traditional industries lag behind, likely slowing down their productivity-enhancing digital adoption.

**Manager selection and management practices could improve.** Managers are key to the digital transformation to initiate and steer product- and process innovations, and they are responsible for assigning and developing human capital. Estonian managers have a low skill premium compared to other countries, and firms make limited use of high-performing work practices known to boost productivity performance and skills use at work.

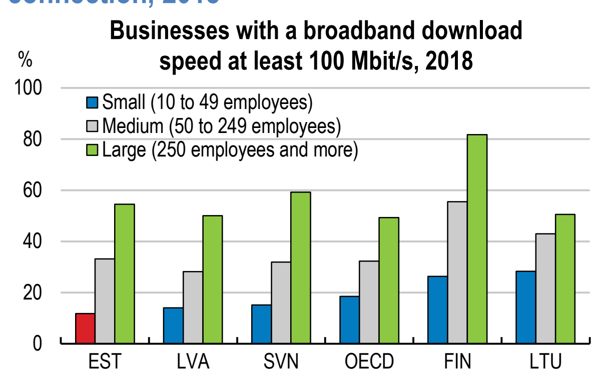
## Figure 4. Managers' skill premium is low




Note: Controlling for sector composition.
Source: OECD calculations based on the OECD Survey of adult skills (2012 and 2015).

**Digitalisation of industry is an imminent challenge**. Access to ultra-fast broadband is one of the major bottlenecks to the adoption of digital technologies, in particular for small firms.

## Figure 5. Few businesses have ultra-high speed connection, 2018




Source: OECD ICT database on business usage.

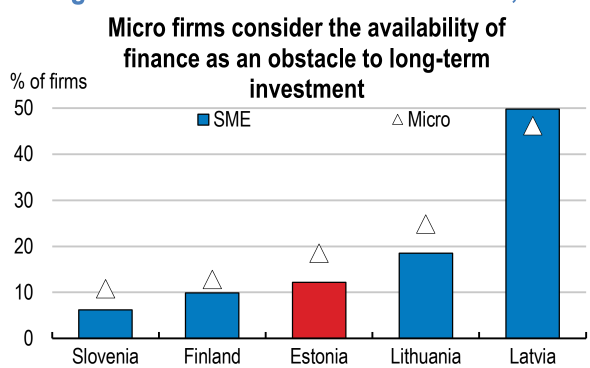
**Embracing digital tools provides a leapfrogging opportunity for Estonian firms**. Big data, the Internet-of-things and artificial intelligence are driving the shift to modern industry in digital frontrunner countries.

**The small scale of firms inhibits boosting productivity through adopting digital tools**. Most firms do not reach the threshold where fixed costs of digital tools are affordable. Digital collaboration within industry associations and ICT clusters could alleviate that issue alongside mergers and joint operations.

**Lack of awareness about the potential benefits of adopting digital tools and the type of tools to adopt are bottlenecks to digital transition.** Bureaucracy should be reduced for digital diagnostics and take-up rates and success stories should be better disseminated.

**Lack of financing is an obstacle to long-term investments,** especially the lack of collateral among new and rural firms**.** Many SMEs' loan applications are rejected and many do not apply in fear of rejection compared to other countries. Alternative financing sources should be explored.

### Figure 6. Availability of finance is an obstacle to long-term investment for smaller firms, 2017




Source: EIB survey.

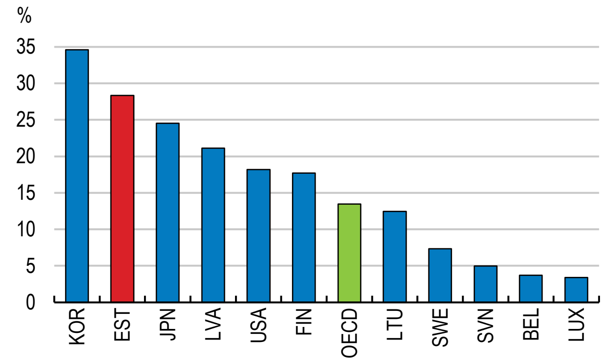
## The benefits of growth need to be more equitably distributed and growth greener

*Robust growth did not benefit all groups of society.*

**Income inequality is around the OECD average,** but social disparities, including inequalities in life satisfaction or health outcomes, are high in some dimensions: between urban and rural, across regions, men and women, skilled and unskilled and citizens and non-citizens. The whole population should be covered by health insurance and non-recipients should be encouraged to enrol.

**The gender wage gap is second highest in the OECD.** Employers, including the private sector, should report the size of the wage gap and provide an action plan to eliminate it.

### Figure 7. The gender wage gap is very high, 2018 or latest year available

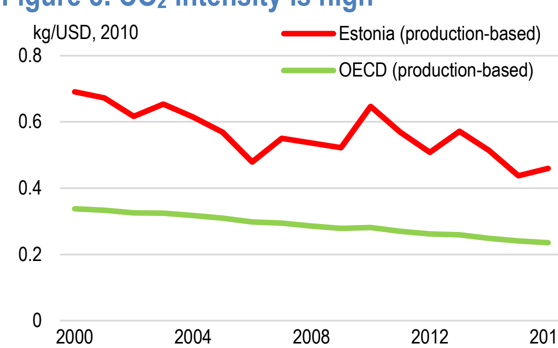



Source: OECD Labour Statistics database.

**Reducing dependence on oil shale is a key environmental, social and strategic challenge**. Estonia is the most carbon intensive and third most energy-intensive economy in the OECD, due to its heavy reliance on oil shale. The industry meets a dominant share of Estonia's energy needs, it accounts for 4% of GDP, it is a key employer in the northeast of the country, where unemployment and poverty rates are high, and it is seen as key to the country's energy security. Efforts towards increased refining improves resource efficiency, but the industry remains polluting and vulnerable to international prices of oil and $CO_2$ emissions.

**The amount of household waste has increased with rising incomes in recent years** and recycling is low, which calls for better infrastructure and incentives to reduce waste and recycle.

### Figure 8. $CO_2$ intensity is high




Source: OECD Green Indicators database.

| MAIN FINDINGS | KEY RECOMMENDATIONS |
|---|---|
| **Creating macroeconomic conditions conducive to growth and well-being** | |
| In the recent cyclical upturn, windfall revenues have been spent, making fiscal policy pro-cyclical. | Avoid pro-cyclical fiscal policy and allow the free play of automatic stabilisers. In case of a strong downturn, fully use the exemption clause built in the existing fiscal rule. |
| Productivity growth has been sluggish. The overall level of subjective well-being is low by OECD standards. | Increase spending on measures boosting the long-term growth potential and inclusiveness such as infrastructure connectivity, innovation and education. |
| Real-estate related tax revenues are low, as the tax base does not include residential housing. Consumption taxes are high. | Introduce a recurrent tax on the ownership of residential real estate. Reduce labour and consumption taxes. |
| A previous proposal to strengthen the legal framework to prevent money laundering and financing of terrorism was not passed by the parliament due to the election cycle. Anti-money-laundering measures have been strengthened considerably, and the Government is preparing a new proposal to Parliament. | Continue strengthening regulations and allow the freezing of assets by the regulator in the case of suspected money laundering and increase fines to deterring levels.<br>Continue to strengthen Baltic-Nordic coordination in the fields of financial sector supervision and anti-money laundering. |
| **Seizing the productive potential of digital change** | |
| The large number of planning documents at the national and sectoral levels contain overlap and industry digitalisation is not sufficiently emphasised. | Formulate policies for industry digitalisation in a holistic way as a means of productivity catch-up and reflect those in government planning documents. Monitor implementation. |
| Estonian companies are little involved in vocational education and training and the continuous training of own employees. | Strengthen cooperation between the public sector, labour unions and employers to boost their engagement in skill supply, including vocational education and training and continuous learning. |
| High-performance work practices boost individuals' skill use at work, digital adoption and productivity performance. Their use in Estonia is around the OECD average. | Implement a programme to improve managerial practices and organisational performance of firms with a strong element of network-building to disseminate good practice and mutual learning. |
| The organisation, content and quality of the teaching of digital skills varies between schools, and teachers do not feel sufficiently prepared to teach digital skills and use digital tools. | Strengthen the quality and relevance of teachers' training and professional development in teaching digital skills. |
| Access to finance is an obstacle to long-term investment for smaller firms and they are rejected or do not apply for loans in fear of rejection. | Promote alternative financing to fill the funding gap for SMEs. |
| **Sharing the benefits of growth in a more equitable way and providing a greener environment** | |
| The second pillar pension funds have charged high fees and returns have been low. The proposed changes to allow withdrawal of funds would generate extra short-term public revenues but would risk pension adequacy and aggravate old-age poverty in the longer term. The impacts of the proposed changes have not been properly assessed, and public consultations have been limited. | Do not allow withdrawal from the second pillar of the pension system before retirement. Assess the impacts of potential changes to the pension system, including on pension adequacy and macroeconomic stability. Enhance competition in pension markets, and make all costs transparent. |
| Health insurance coverage is incomplete and out-of-pocket costs are high. The way to extend coverage to all is being explored. | Extend health insurance coverage for the entire population. Encourage the inactive non-recipients to obtain health insurance. |
| The gender wage gap is high. | Require the reporting of the gender wage gap and action plans to reduce it, including in the private sector. Hold companies accountable for their actions, by for instance requiring explanation for slow progress. |
| An overwhelming majority of ICT specialists are men, reflecting early educational choices. | Tailor ICT classes and voluntary ICT hobby activities to better match the interests of both girls and boys from the early stages of compulsory school and in early childhood education and care. |
| Many unemployed are not covered by unemployment insurance owing to its stringent conditions and hence cannot benefit from active labour market programmes. | Relax eligibility conditions for unemployment insurance. |
| People with low education and skills are more likely to work in jobs more vulnerable to automation and digitalisation. | Continue to scale up and improve access to active labour market policies, notably up-skilling activities for the unemployed, the disabled and those in high risk of unemployment. |
| The oil shale industry is very $CO_2$ intensive. The industry is highly sensitive to international prices on oil and $CO_2$ emissions in the EU Emissions Trading Scheme (ETS). | Review taxes and charges on oil shale mining and use to reflect costs and externalities, while addressing social welfare and energy security concerns. |
| The amount of household waste has increased sharply in recent years and recycling is low. | Improve waste collection infrastructure and raise fees on domestic mixed waste going to incineration or landfills to incentivise recycling and waste prevention. |