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Local democracy in Estonia

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Summary

This report is the outcome of the third monitoring visit to Estonia since it ratified the European Charter of Local Self-government in 1994. The situation of local democracy in Estonia is generally positive. The rapporteurs took note of the recent initiatives endorsed by the national authorities enhancing relations between central government and local authorities with regard to financial matters and the structure of local authorities as a result of the current local and regional government reform. The rapporteurs welcome the fact that in 2011 Estonia ratified the Additional Protocol on the right to participate in the affairs of a local authority. However, the report highlights the lack of clarity in the distribution of powers and responsibilities between local and national authorities, the fact that local authorities do not have sufficient funding to meet their responsibilities, and the absence of arrangements for consulting local authorities at regular intervals and within reasonable time-limits.

The Congress therefore recommends that the Estonian authorities clarify their legislation on the distribution of powers between local and central authorities and ensure that a large number of such powers are delegated to local authorities. It also invites the government to ensure that local authorities have adequate and sufficient funding to enable them to perform their duties in an independent manner. In this connection, the rapporteurs also encourage the Estonian authorities to improve their financial equalisation system. With regard to consultation arrangements, they advocate the introduction of measures to ensure that consultations are held regularly and within reasonable time-limits.

1 L: Chamber of Local Authorities / R: Chamber of Regions
 EPP/CCE: European People's Party Group in the Congress
 SOC: Socialist Group
 ILDG: Independent Liberal and Democratic Group
 ECR: European Conservatives and Reformists Group
 NR: Members not belonging to a political group of the Congress

RECOMMENDATION 401 (2017)²

1. The Congress of Local and Regional Authorities of the Council of Europe refers to:

a. Article 2, paragraph 1.b of Statutory Resolution (2015)9 relating to the Congress, which provides that one of the aims of the Congress shall be “to submit proposals to the Committee of Ministers in order to promote local and regional democracy;”

b. Article 2, paragraph 3 of Statutory Resolution (2015)9 relating to the Congress, stipulating that “The Congress shall prepare on a regular basis country-by-country reports on the situation of local and regional democracy in all member States and in States which have applied to join the Council of Europe, and shall ensure, in particular, that the principles of the European Charter of Local Self-Government are implemented;”

c. Resolution 307(2010)REV2 on procedures for monitoring the obligations and commitments entered into by the Council of Europe member States in respect of their ratification of the European Charter of Local Self-Government;

d. the appended explanatory memorandum on local democracy in Estonia.

2. The Congress notes that:

a. Estonia became a member of the Council of Europe on 14 May 1993. It signed the European Charter of Local Self-Government (ETS No. 122, hereafter “the Charter”) on 4 November 1993 and then ratified it on 16 December 1994. The Charter entered into force with respect to Estonia on 1 April 1995. Estonia made no reservations or declarations with respect to the Charter;

b. Estonia signed and ratified the Additional Protocol to the European Charter of Local Self-Government on the right to participate in the affairs of a local authority (CETS No. 207) on 20 April 2011 with entry into force on 1 June 2012;

c. the Monitoring Committee decided to review the situation of local democracy in Estonia in the light of the Charter. It appointed Mr Henrik Hammar, Sweden (L, EPP/CCE) and Mr Leendert Verbeek, Netherlands (R, SOC) as co-rapporteurs. They were instructed by the Monitoring Committee to prepare and submit to the Congress a report on local democracy in Estonia;

d. the monitoring visit took place from 6 to 8 September 2016. During the visit, the Congress delegation met with representatives of various political institutions such as the Parliament, the Minister of Public Administration, Tallinn City and Ida Viru as well as Järva County, the Western Islands, Chancellor of Justice, National Audit Office and the Supreme Court. The delegation met as well with representatives from the Congress delegation and the associations. The detailed programme of the visit is appended to the explanatory memorandum;

e. the delegation wishes to thank the Estonian authorities at central and local level, the Estonian delegation to the Congress, the national associations of local authorities as well as all the interlocutors met during the visit for their readiness to assist and the information they provided. The delegation also thanks the Ambassador of Estonia to the Council of Europe who contributed to the organisation and smooth running of the visit.

3. The Congress notes with satisfaction:

a. the ratification by Estonia in 2011 of the “Additional Protocol to the European Charter of Local Self-Government on the right to participate in the affairs of a local authority” which illustrate a political commitment toward the participation of citizens in local public affairs;

b. the revision of the State Budget Law (section 46 (2)-(4)) in order to strengthen the interaction between the state and local authorities and their associations on budgetary items;

² Discussed and approved by the Chamber of Local Authorities on 29 March 2017, and adopted by the Congress on 30 March 2017, 3rd sitting (see Document [CPL32\(2017\)04](#), explanatory memorandum), co-rapporteurs: Henrik HAMMAR, Sweden (L, EPP/CCE) and Leendert VERBEEK, Netherlands (R, SOC).

c. the initiatives of the Estonian institutions to start a far reaching reform process of the territorial architecture of the country on local and state level.

4. The Congress expresses its concern at:

a. the lack of clear division of competences between local and state authorities (Article 4.2 and 4.4);

b. the absence of adequate concomitant financial resources for the transfer of competences to local authorities and their overwhelming dependence on state grants and transfers (Article 9.2 -4);

c. the small potential of own resources of local authorities to execute their tasks, especially in rural areas, the weakness of own tax revenues of local authorities (Article 9.3) and the fact that the system of financing of local authorities is neither diversified nor evolutionary (Article 9.4);

d. the fact that in practice the consultations on issues of interest to local authorities are not systematic and their deadlines are too short to allow for the appropriate and effective consultation in the sense of Article 4.6;

e. the lack of clarity of distribution procedures, including the equalisation and the special support schemes, as well as insufficiency of the equalisation fund to cover the needs of local authorities (Article 9.5).

5. The Congress recommends that the Committee of Ministers invite the Estonian authorities to:

a. clarify their legislation concerning the distribution of mandatory tasks and functions between local government and State and transfer a maximum of competences together with concomitant finances to the local level. Such measures could complete the government's approach to strengthening local democracy through merged greater territorial units;

b. combine as far as possible the functional responsibility of the State for a given competence with the financial responsibility to cover the costs of its implementation and refrain from using the state reform on agency level as a hidden transfer of responsibilities to local authorities;

c. change the domestic legislation in line with the accomplishment of the territorial reform in order to give to local authorities more financial autonomy and diversify the financial system of sources of their revenue by improving the local tax system and enlarging the local share in state taxes;

d. ensure in practice reasonable deadlines and regularity of consultations with local authorities on matters concerning them directly in the sense of Article 4.6 of the Charter. The practice of consultation should be adapted to the need of local authorities to follow closely deliberations especially in the field of reform process and local finance matters;

e. increase the dotation to the equalisation fund, review the criteria of its distribution and develop new vertical and horizontal instruments to improve the Estonian fiscal equalisation system and strengthen local fiscal autonomy.

6. The Congress invites the Committee of Ministers of the Council of Europe to take into consideration the present recommendation on local democracy in Estonia, as well as the explanatory memorandum, in its activities related to this member State.

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1. INTRODUCTION, AIM AND SCOPE OF THE VISIT

1. The Republic of Estonia acceded to the Council of Europe on 14 May 1993. Estonia signed the European Charter of Local Self-Government (CETS No. 122, hereafter “the Charter”) on 4 November 1993, and then ratified it on 16 December 1994. The Charter entered into force on 1 April 1995. Estonia has not deposited any reservations or declarations with respect to the Charter.

2. On 16 November 2009 Estonia also signed the Additional Protocol to the European Charter of Local Self-Government on the right to participate in the affairs of a local authority (CETS No. 207), which it ratified on 20 April 2011. This protocol entered into force on 1 June 2012.

3. According to Article 2, paragraph 3, of Statutory Resolution (2015)9 of the Council of Europe Committee of Ministers, the Congress of Local and Regional Authorities (hereinafter referred to as “the Congress”) is to prepare reports on a regular basis concerning the state of local and regional democracy in all member states of the Council of Europe.

4. Up until now, two monitoring reports and Congress recommendations have been produced with respect to Estonia, the first in 2000 (Recommendation 81 (2000) of 24 May 2000 on the situation of local democracy in Estonia) and the second in 2010 (Recommendation 294 (2010) of 28 October 2010 entitled “Local democracy in Estonia”).

5. Pursuant to Resolution 395 (2015) Rule 73ff of the Rules and Procedures of the Congress, the monitoring procedure must be carried out every five years in each Council of Europe member state of the Council of Europe.

6. The Monitoring Committee decided to review the situation of local and regional democracy in Estonia in light of the Charter. It appointed Mr Henrik Hammar from Sweden (L, EPP/CCE) and Mr Leendert Verbeek from the Netherlands (R, SOC) as co-rapporteurs. They were tasked with drawing up a report on local democracy in Estonia and submitting it to the Congress.

7. The monitoring visit in Estonia took place from 6 to 8 September 2016. During the visit the monitoring delegation met with representatives of various political institutions such as the Parliament, the Minister of Public Administration, the Chancellor of Justice, the National Audit Office and the Supreme Court, as well as representatives of Tallinn City, Ida Viru, Järva County and the West Estonian archipelago. The delegation also had meetings with representatives of Estonia's delegation to the Congress and associations and experts. The detailed programme of the visit is appended.

8. The delegation wishes to thank the Estonian authorities at central and local level, as well as the Estonian delegation to the Congress, the national associations of local authorities and all the persons they met during the visit for their readiness to assist and the information they supplied during and after the visit. The delegation also thanks the Ambassador of Estonia to the Council of Europe, who contributed to the organisation and smooth running of the visit.

9. This report has been prepared on the basis of the information and data collected during the monitoring visit, as well as on the basis of additional information from institutions and persons visited in Estonia.

2. CONSTITUTIONAL AND LEGISLATIVE BASES

10. The constitutional and legislative bases in general are unchanged in comparison to the report adopted by the Congress in 2010, so it was possible to refer to this information. Amendments to the Constitution or basic laws of relevance to local self-government, adopted by the parliament in the meantime, have been noted. The most important new law of relevance to local self-government, the Administrative Reform Act of June 2016, will be commented upon in Chapter 3 below.

11. During the consultation process, the rapporteurs were informed that following the amendment to the Constitution, since 2017 the voting age at local elections was lowered from 18 years to 16 years.

3. GENERAL DATA AND POLITICAL CONTEXT, REFORM PROJECTS

12. The Republic of Estonia regained independence on 20 August 1991 after the collapse of the Soviet Union. The territory covers 45 339 square kilometres, with a population of 1 315 994 people (1 January 2016).³ In general, a slight decline in population size can be noted, although this trend differs from one local authority to another and from urban to rural areas. It also depends on immigration and emigration figures. Consequently, the new government has decided to reinforce policies to stabilise the country's demographic development, including immigration.⁴ Details concerning the demographic situation can be found in the Statistical Yearbook of Estonia 2016.⁵

13. Estonia has 213 local authorities; at regional level there are 15 counties, which are deconcentrated state units led by state civil servants called county governors.

14. Estonia became the 27th member state of the Council of Europe on 14 May 1993 and joined the European Union in 2004.

15. The institutional set-up of Estonia is laid down in its Constitution, adopted on 28 June 1992, which entered into force on 3 July 1992.⁶ The function of head of state is exercised by the president, who was elected in 2016 for a five-year term of office. Legislative power is exercised by a unicameral parliament (Riigikogu) which is elected by universal suffrage and a direct and secret ballot for a four-year term of office. The last election took place on 1 March 2015.⁷ All citizens over the age of 18 have the right to vote. The Riigikogu has 101 members. It is currently composed of six factions: the Estonian Reform Party faction has 30 members, while 27 members adhere to the Estonian Centre Party faction, 15 members to the Social Democratic Party faction, 14 members to the Pro Patria and Res Publica Union (IRL), 8 members to the Estonian Free Party faction and 7 members to the Conservative People's Party of Estonia faction.

16. Executive power is vested in the government, consisting of the prime minister and 14 ministers. On 23 November 2016 a new government came to power.⁸ The former coalition between the Estonian Reform Party, the Social Democratic Party and the Pro Patria and Res Publica Union (IRL) split after one-and-a-half year in office: the members of the Reform Party left the government. The new government is a coalition between the Estonian Centre Party, the Social Democratic Party and the Pro Patria and Res Publica Union (IRL), totalling 56 members in the Riigikogu.

17. The judicial branch is governed by Article 148 of the Constitution. The Supreme Court is the highest court in Estonia and reviews court judgments by way of cassation proceedings. The Supreme Court is also the court of constitutional review of all legal acts, including those relating to the ongoing local self-government reforms in Estonia.

18. Concerning its overall political orientations, the new government adopted the "Basic Principles of the Government Coalition for 2016-2019", which also contains, in Chapter VIII, a series of important orientations and planned measures with particular respect to local government and regional policy.⁹

19. Other chapters of these "Basic Principles", if implemented as they were initially written, are extremely important for local authorities. For example, Chapter II point 3 states: "We will implement a zero bureaucracy programme" and Chapter II point 22 states: "We will maintain an average structural balance in the state budget. When using an earlier structural surplus, the deficit of the budget must not exceed 0.5% of GDP per year. If needed, we will use additional foreign capital to finance infrastructure investments with long term profitability." Other reform projects, particularly in the taxation and investment sector, as well as basic orientations, for example, in the labour market and social policy or

3 See more details: <http://www.stat.ee/population>.

4 See Chapter VI, points 4-6 of "Basic Principles of the Government Coalition between the Estonian Centre Party, the Estonian Social Democratic Party, and Pro Patria and Res Publica Union (IRL) for 2016-2019" at https://valitsus.ee/sites/default/files/content-editors/failid/basic_principles_of_the_government_coalition_between_the_estonian_centre_party_the_estonian_social_democratic_party_and_pro_patria_and_res_publica_union_irl_for_2016-2019.pdf

5 Statistical Yearbook of Estonia, ISBN 978-9985-74-593-9, Bilingual: Estonian and English, Published: 27.07.2016.

6 <https://www.president.ee/en/republic-of-estonia/the-constitution/>.

7 See Article 61 of the Estonian Constitution

8 Background information may be found in: <http://estonie-au-quotidien.over-blog.com/2016/11/juri-ratas-succede-a-edgar-savisaar-a-la-presidence-du-parti-du-centre-une-nouvelle-ere-s-ouvre-dans-le-paysage-politique-estonien.h>.

9 See Chapter VIII. Local Governments and Regional Policy of "Basic Principles of the Government Coalition between the Estonian Centre Party, the Estonian Social Democratic Party, and Pro Patria and Res Publica Union (IRL) for 2016-2019"

the housing sector, may have significant implications for the powers and finances of local authorities. The initiatives linked to improving e-government and e-economy¹⁰ are of special relevance for all levels of government.

20. Concerning the principles with respect to state reform and intergovernmental relations, Chapter III of the “Basic Principles” is of special interest as regards the increased powers of local self-government bodies. Subsection 4 stipulates: “We will abolish county governments, transferring their essentially local-government functions to local governments and their joint organisations, and their state monitoring functions to state agencies. We will relocate state agencies to various counties.” Another project will also be of importance for local authorities: Chapter V, subsection 6: “We will create a cross-ministry body of experts to establish a state spatial planning competence in cooperation with the Estonian Association of Architects”.

21. During the visit the rapporteurs had no detailed information as to whether the “two chairs” approach - that is combining local and national mandates (accumulation of mandates) - would actually be implemented. Critics argued that a double mandate for political representatives would not influence local democracy in a positive way, but on the contrary, would bring about centralisation processes. During the consultation process, the Chancellor of Justice provided the following information. The law introducing “two chairs” approach was adopted on 07 June 2016. Its entry into force was planned for 16 October 2017 (on 17 October 2017 the re-election to local councils will take place). Several local governments have initiated constitutional review proceeding on the matter in the Supreme Court. The case is still pending in the Supreme Court.

4. ADMINISTRATIVE TERRITORIAL REFORM PROJECTS

22. The most important topic is actually the “Administrative Territorial Reform”¹¹ based on the Administrative Reform Act.¹² Bearing in mind that voluntary mergers of local authorities, which were always possible in the past,¹³ had not yet been carried out, according to the government, the former government changed the amalgamation strategy to a considerable extent and presented a law to oblige local authorities to decide upon voluntary mergers within a given legal deadline before the end of 2016.¹⁴ The law gives a legal definition of the main purposes of the reform¹⁵ and determines the procedures as well as the financial frameworks to support the reform targets. The National Audit Office informed the rapporteurs that it supports the core elements of the reform and underlined the need to carry out an administrative reform before 2017, but had to admit that the main obstacle to administrative reform is the incapability of parties to reach a political agreement. The National Audit Office considers that the principles of the 2016 reform are generally very good. Local government bodies can decide for themselves whom to merge with; the state supports local government in carrying out the voluntary merger process by providing them consultants and request advice from regional committees; and the reform does not prevent local government authorities from merging across county borders and, in justified cases, from merging different parts of local governments in a direction suitable for them, while taking into consideration the identity and organisation of community life. It is now clear that the administrative reform will be carried out voluntarily in most local governments. The government will have to make proposals for compulsory mergers in some cases, but even then it will be possible for the merging local governments to agree on the conditions of the merger. The National Audit Office has drawn the attention of the government to the reform criterion of 5000 residents, which in some cases may be too low in light of future developments. Considering the goal of the reform, the government should have broader discretion at the compulsory merger stage. The National Audit Office also drew the attention of the government to the fact that the exceptions existing by law may hinder achievement of the goal of the reform. The National Audit Office deems it problematic that the functions and funding of local governments will be reviewed after the administrative reform has been completed.

10 See Chapter 19, subsection 3: “We will develop a broadband distribution network in a partnership between the state, local governments and the private sector.”

11 See also: Kalle Merusk, Vallo Olle, “Problems of Estonian Local Government in 2013 and Co-operation as an Instrument of Their Resolution” (<http://www.juridicainternational.eu/index.php?id=15332>).

12 <https://www.riigiteataja.ee/en/eli/514072016004/consolide>, passed 07.06.2016.

13 Earlier local government reform projects in Estonia are analysed by Vallo Olle in “Local Government Reform in Estonia (1989-1996)” at (<http://www.juridicainternational.eu/?id=12437>).

14 See details concerning deadlines in section 4, paragraph 1, of the Administrative Reform Act.

15 See section 1, paragraph 2, of the Administrative Reform Act.

23. The reform project has two phases. The first phase is a voluntary phase, with direct merger negotiations between local self-government units. According to the figures given by the Ministry of Finance (as of 22 September 2016), 183 municipalities out of 213 are engaged in reform process negotiations (that is to say, these municipalities have agreed to hold amalgamation talks). However, local authorities are not completely independent in the organisation of these procedures. Article 5 of the Administrative Reform Act creates special bodies – regional committees – to give advice to local government. The specific functions of these committees are determined by the law. There will be a mandatory merger phase, directed by the state government, if negotiations fail. The central target is to form new local government units with at least 5000 residents as a minimum criterion. Section 9, paragraph 3, of the law contains four exceptions to the target number of residents in respect of territories with a small population.

24. As an important financial incentive, local government authorities that carry out successful merger negotiations will have access to merger grants varying in amount from €300 000 to €800 000.¹⁶ The Minister of Public Administration¹⁷ in functions explained to the rapporteurs that local government authorities meeting the criteria will receive double the former merger grant amount (previously they received €50/inhabitant, therefore a minimum of €150 000 and a maximum of €400 000; now they can receive €100/inhabitant, therefore a minimum of €300 000 and a maximum of €800 000 per merging local authority). If local authorities merge voluntarily, but do not meet the criteria, the grant will be a figure between the old and new amounts. There is also a €500 000 grant for local authorities which merge into local authority units exceeding 11 000 residents (this would be the desired size of local authorities; the target of 5000 residents is the minimum criterion) or reach the size of a current county. Intermunicipal co-operation will be enhanced via better organisation on the basis of the law and some state tasks will be transferred to local authorities, along with adequate funds. The Minister of Public Administration in functions¹⁸ has estimated that, as a result of the reform, there could be fewer than 100 local authorities left. He predicts that approximately one third of the municipalities should reach the 5000 resident target and the rest would have 5000-9000 inhabitants, except for small islands that qualify for exceptions.

25. It should be added that as regards compulsory mergers, that is initiated by the government the €100 000 limit on compensation for them has been criticised.¹⁹ During the consultation process the Chancellor of Justice informed the rapporteurs that the limitation of compensation for the mergers initiated by the government had been repealed by the Supreme Court. In case of a compulsory merger all effective costs will henceforth be covered without any limit (but no additional dotation will be provided unlike for the voluntary amalgamations).

26. Through monitoring missions in other Council of Europe member states, the rapporteurs have acquired knowledge of different national government approaches for supporting merger processes through financial incentives in favour of amalgamated local units. The Chancellor of Justice told the rapporteurs that the wish of the legislature to guide local authorities towards a voluntary merger, by way of paying a merger grant as well as a bonus, is a relevant consideration.²⁰ The rapporteurs believe that the state government could take charge of local debt, under certain conditions, so as to stabilise the financial soundness of a newly formed local-government unit.

27. Section 6 of the Administrative Reform Act²¹ is of special relevance to guarantee the effective participation of residents in this reform process. Residents should be consulted concerning the assignment of local authorities, or parts of them, to other local units.

28. During meetings with representatives from different local authorities, the rapporteurs received a great deal of information about the ongoing discussion and negotiation process. Evidently, a great majority of the local authorities concerned are engaged in these negotiations and are ready to comply with central targets. Nevertheless, the reform project is also subject to legal proceedings; 26 local government authorities lodged a complaint with the Supreme Court. The Supreme Court in its judgment of 20 December 2016, No. 3-4-1-3-16, repealed section 24, paragraph 1, of the Administrative Reform Act.²² In practice, the cap clause in section 24, paragraph 1, sentence 2 of the

16 See details in section 20 of the Administrative Reform Act: "Basis for paying merger grant and rates thereof".

17 From 23 November 2016 the new Minister of Public Administration of the Republic of Estonia is in functions.

18 See footnote 16.

19 See Chapter III of the Chancellor of Justice opinion from 29 August 2016.

20 See Opinion from 29 August 2016, page 11.

21 See section 6 on the determination of the opinion of residents of the Territory of Estonia Administrative Division Act.

22 See section 24 of the Administrative Reform Act "Covering costs related to alteration of administrative-territorial organisation

Administrative Reform Act has been deleted, so that the central government has to pay sums in excess of €100 000 in the case of mergers initiated by the government. Concerning the other elements of the Act, the Court did not declare any unconstitutionality. In particular, the reform deadlines to be respected in due time before the upcoming local elections in 2017 are, as the Court understands it, “not unreasonably short” (paragraph 179 of the judgment). The implementation of the Administrative Reform Act may continue as planned under the procedure adopted by the government.

29. There is no indication whether the new government, in office since November 2016, will alter other core elements of the reform or change deadlines and procedures with a view to softening the reform process. The decision of the Supreme Court has clarified the legality of the reform and given limited indications concerning the extent to which legal and financial modifications will be necessary.

30. Experts, as well as representatives from local authorities and their associations, raised some arguments against the reform, although the rapporteurs did not encounter any substantial opposition vis-à-vis the reform project. During the visit it was stressed that the number of residents should not become the only decisive criterion in the reform. Clearly, the need to attain “economies of scale” also serves as a basis for organising public administrations. However, there may be other criteria: the volume of their own or delegated powers and the financial capacity of local units, as well as geographical or socio-economic factors, which may also affect local administrative capacity to cope with differing numbers of residents. During the consultation process, the Chancellor of Justice informed the rapporteurs that the Government shared this approach which was also confirmed by the Supreme Court stating that the number of residents was only one element and the geographical or socio-economic factors named in the § 7 (5) of the Territory of Estonia Administrative Division Act must be taken into account, especially in the case of mergers initiated by the government. The number of residents gives only the justification for initiation of the merger, but while deciding whether to conclude the initiated merger or not, government has to weigh up all the elements, including the local councils opinions on these elements.

31. Another weak point is – in the eyes of local representatives – a lack of cohesion in the reform and the follow-up of further reform measures. Many representatives have argued that the issues of deadlines, merger criteria, financial consequences and future tasks should have been dealt with within the reform package. However, that is not the case, as the government is clearly willing to divide the reform package into several elements. In particular, the government has not yet presented detailed information about the issue of which new functions will belong to amalgamated larger units, what financial status these units will have and how the efficiency and effectiveness of newly reorganised local administrations could be improved. The Minister of Public Administration in functions²³ prepared some suggestions for improving the financial stability of merged local authorities. He underlined that the “increase of local authority revenues could be operated by increasing the share of personal income tax and reorganizing its distribution mechanism, increasing the amount of the equalization fund and reorganizing its distribution formula by focusing more on costs related to youth/ pupils and introducing a periphery parameter into the equalization formula etc. Those changes, if decided and implemented, will be implemented in all municipalities, not only in merged municipalities. Additional financial consequences of mergers may occur to municipalities applying for investment support (either from EU funds or from state budget), because according to the law and additional government decisions merged municipalities have to be preferred in financial terms if possible”. During the consultation process the Ministry of Finance informed the delegation that according to the coalition agreement there were several tasks that the Minister of public administration had to fulfil by spring 2017, notably prepare proposals to amend local government revenue base and to increase financial autonomy, amend income tax law (point 8.2 and 8.3 in coalition agreement) through raising the personal income tax and providing local governments with new tasks with sufficient funding. However, the rapporteurs are of the opinion that there are no guarantees if the new government will continue in line with these proposals.

of rural municipalities and cities initiated by the Government of the Republic”.
²³ See footnote 16.

32. The rapporteurs concur with these criticisms raised by local representatives, although it would probably not be possible for the government to provide substantial detailed information on other parts of the reform package if the necessary rulings have not yet been drafted nor been the subject of a political decision at the level of the government. The rapporteurs would suggest that the government should, if necessary in a special consultation process with the local associations, provide more information on whether and to what extent future reform steps would target local authorities in Estonia (the Ministry of Finance however stressed that such process of consultation was on-going). The criteria of section 7, paragraph 5, of the Territory of Estonia Administrative Division Act could be helpful to address core topics, for which detailed information may be useful. In accordance with the above-mentioned provision of the Territory of Estonia Administrative Division Act, “the following circumstances shall be taken into consideration upon initiation of the administrative-territorial organisation reform:

- historical factors;
- the impact on living conditions;
- the sense of cohesion of residents;
- the effect on the quality of provision of public services;
- the impact on administrative efficiency;
- the effect on demographic situation;
- the effect on the organisation of transport and communications;
- the implications for the business environment;
- the effect on the education situation;
- organisational functioning of local government as a common service area”.

33. In constitutional terms, a considerable number of local government units will cease to exist as independent legal subjects and the Supreme Court may have to decide whether Article 155 of the Estonian Constitution calls for a minimum number of local units or if a sensible reduction in the number of local self-government units will breach the principles of the institutional guarantee with regard to these units. Practical aspects may be important too, such as the question of whether the reform process will be cleared in due time to allow for fair preparation of the local elections. In her opinion, in the constitutional review case 3-4-1-2-16 from 29 August 2016, the Chancellor of Justice stated that the planned administrative territorial reform can be carried out in a constitutional manner if the legislature defers the final decision on a forced merger to the period following the regular local elections (voluntary mergers and the election of new councils on the basis thereof can be carried out in compliance with the Constitution based on the time limits established in the Administrative Reform Act). In such an event, the elections of local authority councils are to be held in accordance with section 4 of the Local Councils Elections Act (also depending on the situation between regular elections). Should a forced merger be contested on the basis of section 7 of the Judicial Constitutional Review Procedure Act, a special rule regarding the deadline for challenging a forced merger should be established in such a manner that the aforementioned situation could not arise again. The Supreme Court had no objections concerning the deadline issue in its judgment of 20 December 2016.

4.1 General budget principles and local self-government

34. The Estonian Constitution contains some basic provisions with regard to local finances.²⁴ The details are regulated in the Local Government Organisation Act, the Local Government Financial Management Act and other specific legal instruments. In its Constitutional Judgment No. 3-4-1-8-09 of 16 March 2010 the Supreme Court developed some core elements that the state has to respect when establishing the local authorities funding system.²⁵ The rapporteurs welcome the fact that the Court has underlined the legal importance of the Charter, particularly Article 9, which is to be respected in internal legislation. Nevertheless, the Court gives the legislature discretionary power to “decide what sources (e.g. accrual of state taxes directly to the local budget, allocations from the state budget, local taxes, etc.) the sufficient funds must come from”. This power includes the right of the legislature to react, by streamlining the yearly state budget in response to macroeconomic developments at an international level or to the needs of foreign or defence policy, which significantly affect the Estonian economy and budget priorities. Representatives from the state and the local level may have a different perception of issues linked to fair balancing of benefits and burdens as an outcome of external shocks

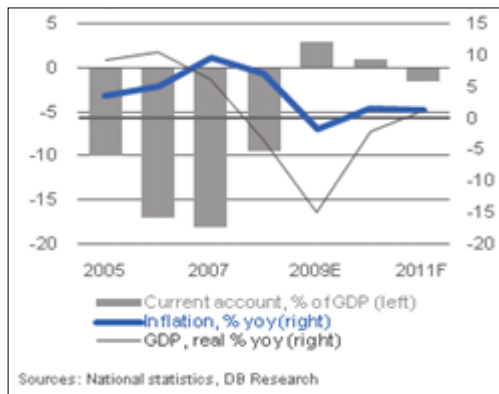
²⁴ Article 157.

A local government shall have an independent budget for which the bases and procedure for drafting shall be provided by law. A local government has the right, on the basis of law, to levy and collect taxes, and to impose duties.

²⁵ See paragraphs 56-61 of the Constitutional Judgement 3-4-1-8-09 from 16 March 2010 of the Estonian Supreme Court.

to the economy and how to distribute the financial consequences between the levels of government.

35. Estonia was hit hard by the international financial and economic crisis in 2008. The chart below,²⁶ from February 2010, shows the deep decline in Estonian GDP in 2009, and also the fast recovery in the following years.



These experiences have led the central government to adopt a very restrictive public budgeting policy. They clearly follow the theory that excessive indebtedness hinders strong increases in GDP growth.²⁷ Although the economy recovered quickly, the government was prudent about increasing expenditure. The effects of this policy are not limited to central state budgeting but also affect local authorities' budgets.²⁸ The financial discretion of local government would also be limited if the central government implemented a restrictive budgetary policy.

36. The Organisation for Economic Co-operation and Development (OECD) chart from November 2016: "Demand, output and prices"²⁹ shows some very low figures with respect to the "General government debt, Maastricht definition". This figure will be around 10% in coming years. In conclusion, the OECD advocates more dynamic budgetary behaviour.³⁰ The following chart shows the very low general budget deficit of Estonia in comparison with other eurozone member states in central and eastern Europe.

²⁶ [https://www.dbresearch.com/servlet/reweb2.ReWEB?document=PROD000000000254450&rwnode=DBR_INTERNET_EN-PROD\\$NAVIGATION&rwobj=ReDisplay.Start.class&rwsite=DBR_INTERNET_EN-PROD](https://www.dbresearch.com/servlet/reweb2.ReWEB?document=PROD000000000254450&rwnode=DBR_INTERNET_EN-PROD$NAVIGATION&rwobj=ReDisplay.Start.class&rwsite=DBR_INTERNET_EN-PROD)

²⁷ See Carmen Reinhart, The Perils of Debt Complacency, from 28.9.2016

https://www.project-syndicate.org/commentary/skidelsky-wrong-on-debt-by-carmen-reinhart-2016-09?utm_source=Project+Syndicate+Newsletter&utm_campaign=4c795047d4-

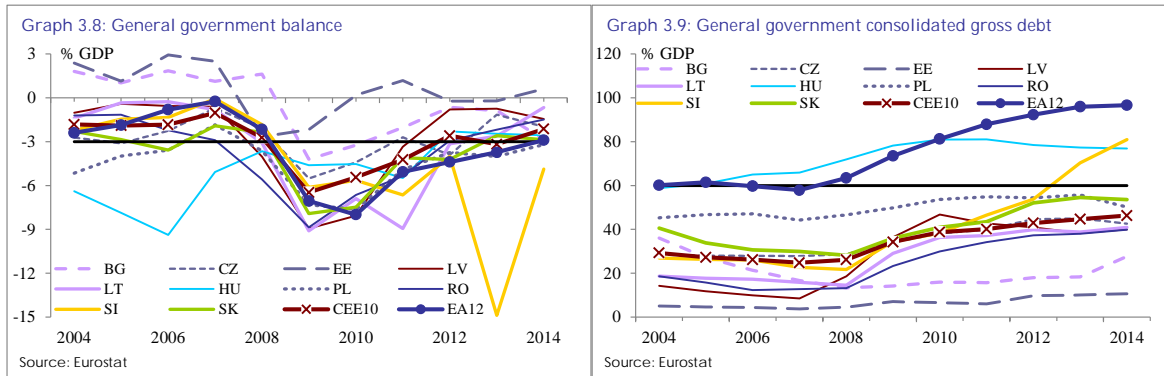
[Roubini_Return_Fiscal_Policy_2_10_2016&utm_medium=email&utm_term=0_73bad5b7d8-4c795047d4-93748893](https://www.project-syndicate.org/commentary/skidelsky-wrong-on-debt-by-carmen-reinhart-2016-09?utm_source=Project+Syndicate+Newsletter&utm_campaign=4c795047d4-Roubini_Return_Fiscal_Policy_2_10_2016&utm_medium=email&utm_term=0_73bad5b7d8-4c795047d4-93748893)

²⁸ The National Audit Office prepared two overviews of the impacts of the economic crisis on local governments:

- Analysis of changes in the revenue and expenditure as well as financial situation of rural municipalities and cities in 2009.
- Impacts of the decrease in revenue on the activities of municipalities and cities through 2009–2010. Overview.

²⁹ <http://www.oecd.org/eco/outlook/economic-forecast-summary-estonia-oecd-economic-outlook-november-2016.pdf>

³⁰ See OECD Economic Outlook, Volume 2016, Issue 2, p.143



Source: EU Commission, Economic Convergence of Central and Eastern European EU member states over the last decade (2004-2014), Discussion paper 001, July 2015 http://ec.europa.eu/economy_finance/publications/.

According to the “Basic Principles”, the new Estonian coalition agreed to maintain, in general, an average structural balance in the state budget, but, if there were surpluses in previous years, to allow a budget deficit in Maastricht terms of up to -0.5%.³¹ The Estonian state budget for 2017 was voted on 19 December 2016.³² The total will be €9.57 billion and will represent an increase of 7.3%. The budget represents a surplus of +0.2% in Maastricht terms, 0.7% less than in 2016. The consequences for the budgetary policy of local authorities will depend on the sectoral budget lines.

3. DEVELOPMENTS IN INDIVIDUAL OECD AND SELECTED NON-MEMBER ECONOMIES

Estonia: Demand, output and prices

	2013	2014	2015	2016	2017	2018
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	18.9	2.7	1.5	1.1	2.4	2.9
Private consumption	9.7	3.4	4.8	3.2	2.7	2.5
Government consumption	3.6	2.5	3.4	0.1	1.5	1.3
Gross fixed capital formation	5.1	-6.9	-3.7	3.2	3.2	4.1
Final domestic demand	18.4	0.4	2.3	2.5	2.5	2.7
Stockbuilding ¹	0.1	2.4	-1.5	0.8	-0.2	0.0
Total domestic demand	18.5	3.0	0.7	3.4	2.3	2.7
Exports of goods and services	16.0	3.1	-0.6	3.9	3.8	4.3
Imports of goods and services	15.6	2.2	-1.4	6.6	3.5	4.1
Net exports ¹	0.4	0.8	0.6	-1.8	0.3	0.3
<i>Memorandum items</i>						
GDP deflator	—	1.9	1.0	1.7	2.4	2.6
Harmonised index of consumer prices	—	0.5	0.1	0.8	2.3	2.6
Private consumption deflator	—	0.5	0.0	0.7	2.3	2.6
Unemployment rate	—	7.4	6.2	6.9	7.6	8.0
General government financial balance ²	—	0.7	0.1	0.4	-0.5	-0.1
General government gross debt ²	—	14.1	12.9	12.4	13.1	13.3
General government debt, Maastricht definition ²	—	10.7	10.1	9.5	10.2	10.4
Current account balance ²	—	0.9	2.2	0.9	0.7	0.8

1. Contributions to changes in real GDP, actual amount in the first column.
 2. As a percentage of GDP.
 Source: OECD Economic Outlook 100 database.

StatLink <http://dx.doi.org/10.1787/888933439037>

37. With regard to the revenue structure of local finances, the following table, produced by the Minister of Public Administration in functions³³, gives some more indications. Total state revenues in 2015 were approximately €7.3 billion,³⁴ the local parts representing a share of 28.6%. Concerning “State grants for current expenses”, the biggest earmarked allocation from the state budget was education support, the majority of which had to be used to pay teachers' salaries. Concerning “Other

31 See Chapter II “Economic Policy, State Investments and Taxation” of the “Basic Principles of the Government Coalition between the Estonian Centre Party, the Estonian Social Democratic Party, and Pro Patria and Res Publica Union (IRL) for 2016-2019”

32 <https://www.riigikogu.ee/en/sitting-reviews/next-years-state-budget-passed-second-reading-riigikogu/>

33 See footnote 16.

34 See Statistics Estonia from 26 November 2016 - <https://www.stat.ee/53721>

local taxes” the table indicates a quota of 5%. Representatives of local authorities have a different viewpoint. They consider that the share of local taxes is only 2% of their revenues at most.

Table 1. Revenues 2015 (Million euros)*

Subsector	Accounting subgroup	2015	%
Local Governments	Revenue from sale of fixed assets	14	1%
	Grants received for acquisition of fixed assets	59	4%
	Revenue from sale of shares	3	0%
	Revenue from sale of other shares	0	0%
	Received payments of loans	0	0%
	Financial revenues	10	1%
	Other primary revenues	18	1%
	Grants received for current expenses**	399	25%
	Other local taxes	71	5%
	Personal income tax	860	55%
	Revenue from sale of goods and services	137	9%
	Total	1 571	100%
Local Governments owned entities	Revenue from sale of fixed assets	2	0%
	Grants received for acquisition of fixed assets	78	15%
	Received payments of loans	1	0%
	Financial revenues	0	0%
	Other primary revenues	1	0%
	Grants received for current expenses	99	19%
	Revenue from sale of goods and services	337	65%
	Total	518	100%
Total		2 090	

*Includes all transfers between local government authorities and the entities owned by them.

** Includes the yield of the equalisation fund in an amount of €76 million

38. Nevertheless, representatives from local authorities take a different view of the question of a fair balance with respect to the distribution of revenues between the levels of government. To quote the position adopted by the Estonian local government associations on 30 December 2015 in respect of the preparation of the Ministry of Finance’s draft state budget strategy for the period 2017-2020:

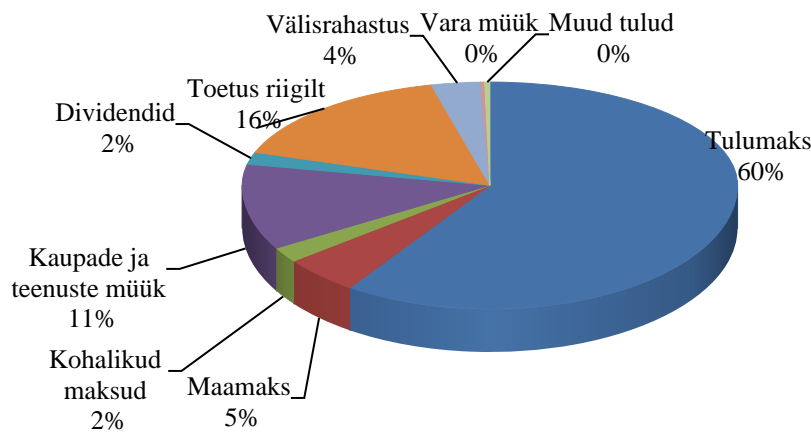
In relation with the preparation of the state budget strategy for years 2017-2020 we continuously repeat that opportunities for local government budgets are not commensurate with the tasks laid upon them. While in ten previous years local government revenues increased by 76,9% (653 772 000 €), the state budget has increased at the same time by 163,4% (4 844 104 000 €). Thereby also the state budget net revenues (social tax, transmitted taxes and allocations to local governments from the state budget not be taken into consideration) have increased by 139,8% (2 322 252 000 €). Total revenues of local government budgets compared to state budget net revenues have decreased from 51,2% in 2004 to 37,8%, allocations made from the net state budget to local budgets have decreased from 17,9% in 2004 to 11,2%.

39. The rapporteurs have discussed the financial situation of local authorities in depth with their representatives. During the consultation process, the Ministry of Finance has informed the delegation that local governments have total control over personal income tax they receive and there are no limits set by the government. The same applies to the use of equalization fund. However, the main objections remain: the small amount of autonomy enjoyed by local authorities to introduce taxes as important locally owned resources; the increase in expenditure particularly in the sectors of education, social work and infrastructure (local roads); the dependence on state grants and transfers (particularly those organised through income tax); and the asymmetric development of revenues at state and local level. According to the National Audit Office, local government authorities do not have many possibilities of shaping their revenues, for example, by establishing local taxes. A large part of local government tasks are financed via targeted support from the state budget, which means that local authorities cannot decide themselves on the manner in which to perform a task, as it is too highly regulated by the state. There is also no guarantee that the revenue base of local authorities will contain enough money for the performance of their functions or that they will be able to raise more money themselves. Some local authorities do not have enough own funds to meet investment needs.

Poorer local authorities are particularly dependent on the state and its support, and only the wealthier ones (20%) have the capability of self-financing. There is also no guarantee that all of the public functions that local governments must perform will be funded from the state budget and all expenses will be compensated, because funding principles are normally generalizing and there may be difficulties in adapting them to particular circumstances.

40. There is clear evidence of a certain deterioration in the financial stability of local authorities in comparison to the situation before the 2008 financial crisis. At least, the increase in revenue and expenditure since 2009 has been greater at central state level than at local level. These trends may have generated a backlog in adapting local authorities' policies to the needs of the population. On the other hand, Estonian local authorities face a similar problem to their counterparts in many other Council of Europe member states where local taxation is concerned: political representatives in local self-government units have clearly not been interested in introducing local taxes. During the consultation process, the rapporteurs received the information that the national associations of local authorities had for many years asked for the revision of the list of the local taxes and that new taxes should be added to the list, including the tourism tax which was not on the list of local taxes.

41. The following chart shows the revenue side of the Tallinn budget for 2016. The city budget is approximately €700 million. According to the figures, the percentage of local taxes in the Tallinn City budget is 2%.



Tulumaks – Income tax
 Muud tulud – Other revenue
 Vara müük – sale of property
 Välisrahastus – External funding
 Toetus riigilt – Support from the state
 Dividendi – Dividends
 Kaupade ja teenuste müük – Sale of goods and services
 Kohalikud maksud – Local taxes
 Maamaks – Land tax

42. Preventing corruption is also important in order to guarantee sound public administration budgeting at local level. Within the “Corruption Perceptions Index” published by Transparency International, Estonia is ranked 22 out of 176 countries. The National Audit Office has made this aspect an essential part of its activity.³⁵ Audits related to the prevention of corruption form one of the most important areas the National Audit Office has dealt with in local government over the last 10 years. The biggest audits in this field concerned: the prevention of corruption in the organisation of work in rural municipalities and cities; the prevention of corruption in the transactions of municipalities and cities; and the use of advertising and communication funds in local authorities. At the moment, the National Audit Office is conducting another audit aimed at the prevention of corruption, which focuses more on the associations established by local authorities. The National Audit Office has helped prevent corruption among local government leaders and officials by speaking at regularly organised training events and seminars. The audits by the National Audit Office have served as an input for the preparation of the state’s anti-corruption strategy and the development of draft legislation.

43. The rapporteurs noticed the difficulties arising in the financial structures of the Estonian local self-government system and in effectively implementing the local development plan³⁶ and budget strategy³⁷ provided for by law. There is a need to carry out an in-depth reform of the financial basis, financial relations between the levels of government and the link to growth-orientated local budgeting in future. The new government clearly concurs with the need for reform. The “Basic Principles” adopted by the new coalition government contain several elements whose direct impact is to strengthen local finances.³⁸

4.2 Financial equalisation

44. Vertical financial equalisation in Estonia is a fairly significant phenomenon. In 2016, 173 municipalities out of 213 received financial support from the equalisation fund. The State Budget Act³⁹ establishes instruments to give special support to local authorities. The main instruments are enumerated in section 46 of the State Budget Act.⁴⁰ Section 47, introducing an equalisation fund,⁴¹ is of special relevance and the technical details are laid down by an order of the Government of the Republic. The main aim of the fund is “to harmonise the opportunities for performance of the functions of the local government entities” section 47, paragraph 2, sentence 1. During the consultation process a representative of the Tallin City government informed the rapporteurs that the biggest allocation from the state budget that reached local governments through the equalisation fund was the education support.

45. The criteria relevant to the aims and structure of a financial equalisation system take into account the number of inhabitants, revenues over the last three years and the estimated costs of the municipality (estimated by central government based on the funds available and not on actual needs). Specific funding is given to the islands in consideration of their low population density and periphery aspects. From 2017 the reduction in state payments out of the equalisation fund will be limited – the portion corresponding to the “estimated costs” of the municipality cannot decrease by more than 2% a year (currently, when the other revenues of the municipality increase, the equalisation fund decreases more or less in the same proportion, so the municipalities are not eager to look for ways to increase their revenues). In addition, the Ministry of Finance has proposed that, starting from 2018, a “peripheral region” component might be added to the formula for calculating the equalisation fund, but no further details are currently available.

46. The government takes into account the personal income tax and land tax revenues of the municipalities. Overall, 90% of the deficit is covered by the equalisation system if these revenues are lower than the calculated expenditure needs. In order to calculate the expenditure needed, the government mainly takes into account the different demographic situation in each municipality. The level of the equalisation fund was €76 million in 2016. The overall effects of the equalisation scheme may be seen in Graph 1 below. The equalisation system naturally has moderating effects to reduce

³⁵ See the [Summary of audit results of the National Audit Office on Prevention of corruption in the organisation of work in rural municipalities and cities, Prevention of corruption in the transactions of municipalities and cities, Use of advertising and communication funds in local authorities](#)

³⁶ Section 37, paragraph 2, of the Local Government Organisation Act.

³⁷ Section 20 par.1 Local Government Financial Management Act.

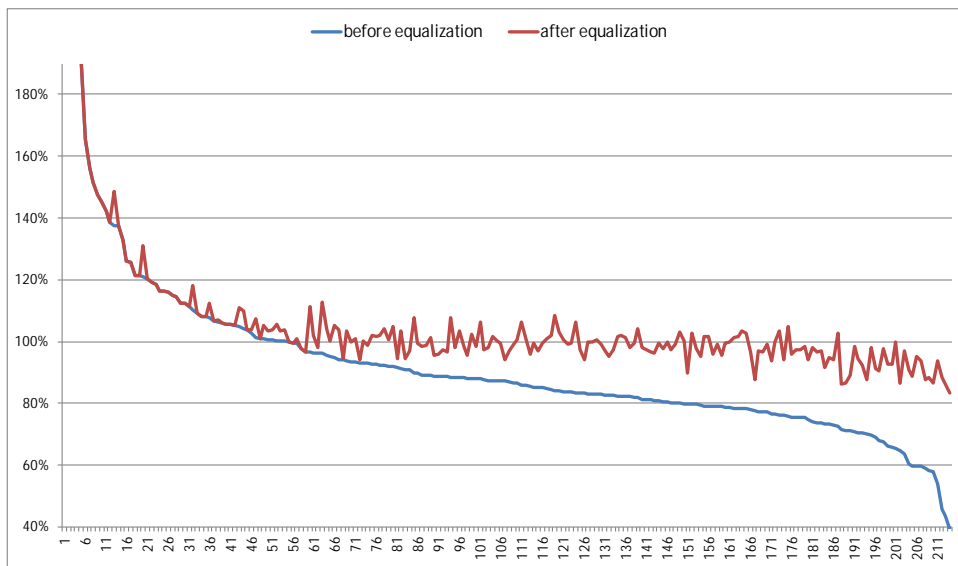
³⁸ See Chapter “VIII. Local Governments and Regional Policy” of “Basic Principles of the Government Coalition between the Estonian Centre Party, the Estonian Social Democratic Party, and Pro Patria and Res Publica Union (IRL) for 2016-2019”

³⁹ State Budget Act Adopted 19.02.2014, RT I, 13 March 2014, 2, Entry into force 23 March 2014, partially on 01 January 2015 and 01 January 2017.

⁴⁰ See section 46 “Connection between state budget and local government budgets” of the State Budget Act.

⁴¹ See section 47 “Equalisation fund” of the State Budget Act.

the difference in revenues between different types of local authorities. The former government had initiated a discussion as to whether the equalisation scheme should be modified. The new government is committed to reforming the local finance system,⁴² but has not yet given specific details concerning the issue of equalisation.



Graph 1. Personal income tax, land tax and natural resource fees equalisation per capita compared to municipal average in 2015.

Changes to local government financing, including equalisation, are under discussion.

47. The Tallinn city administration provided some additional information with respect to the effects of equalisation. In Estonia, financial equalisation was introduced at the time of the income tax reform in 2003. Local authorities were promised that the reform would not harm the situation of local government. However, the method of calculating the personal income tax paid to local authorities was changed. This amendment was advantageous for local authorities where the local gross income per inhabitant was lower which is effectively one of the main purposes of financial equalization system. The decision to strengthen the revenue basis of weaker local authorities was therefore made in the course of the income tax reform and before the economic crisis.

48. The former City Treasury Department made some calculations based on the Tax Board data, which show that, in order to restore the situation that existed before the income tax reform, it would be necessary to allocate 12.1% of personal income tax. The figure as shown in the table is only 11.4%, entailing a loss of revenue for local authorities. However, the results from various concurring sources show that today this figure rather amounts to 11.6%.

⁴² See Chapter VIII point 2 and 3 of "Basic Principles of the Government Coalition between the Estonian Centre Party, the Estonian Social Democratic Party, and Pro Patria and Res Publica Union (IRL) for 2016-2019"

	Local government	Gross income per month in krooni	Allocation of income tax from gross income to local government		
			Before income tax reform (2003 method, basic Exemption 1000 krooni)	In 2004	
				pre-reform method basic exemption 1400 krooni)	after income tax reform
1	Rural municipality with low revenues status quo (reform did not change revenue)	3,500	10.0	8.1	11.4
2	Average rural municipality in Tartu County	5,347	11.4	10.3	11.4
3	Average rural municipality in Estonia	6,565	11.9	11.1	11.4
4	Tallinn	7,260	12.1	11.4	11.4
5	Viimsi	8,850	12.5	12.1	11.4
6		10,000	12.7	12.3	11.4

Source: calculations by Tallinn City Treasury Department based on Tax Board data

According to Tallinn's representatives, the equalisation scheme needs reform and improvement and has to take into consideration the post-crisis financial development of local authorities.

49. Bearing in mind the ongoing amalgamation process and the important changes to the territorial structures of local self-government units, the rapporteurs believe it necessary to reflect on the core orientations of this fund after completion of the territorial reform. It might be necessary to review the budgetary provisions in respect of equalisation, as well as the distribution criteria, even if, in the case of mergers, local government units still lack the level of competitiveness needed to cover costs linked to the provision of local services, due to specific extra charges arising from their peripheral, socioeconomic or geographical situation. Representatives of the West Estonian archipelago have proposed the idea of special tax regimes for peripheral regions,⁴³ which may also need to be taken into consideration. Bearing in mind that the new government will reduce the corporate tax rate to 14% (from 20%) and adopt specific measures to ease income tax, the margin of discretion for introducing specific regional tax schemes seems very small.

50. During the consultation process the Ministry of Finance has informed the rapporteurs that the equalization fund is a fixed figure, which is fed from state budget. Currently the amount is 77 Million € and there is a political discussion about whether and by how much it will be increased in future. The rapporteurs suggest guaranteeing at least the current level of the equalisation fund to help local authorities with structural difficulties in future.

4.3 Additional aid schemes

51. Estonian laws⁴⁴ establish a number of important instruments to guarantee financial discipline at local level. There are limits on local government borrowing and on the financial outcome of primary activities.⁴⁵ Local authorities can have a net debt level of 60-100 per cent from primary revenues depending on their financial capacity. The financial outcome of their primary activities must also be balanced or positive. To re-establish financial discipline, the law provides for a "recovery plan".⁴⁶ One important element is section 47, paragraph 4.9: a recovery plan may include "proposals for amending local government legislation, if necessary". These measures may be effective on both the revenue and the expenditure side of the budget, including legislation to implement local taxes or to increase the outcome of existing local taxes through increased tax bases or rates. The government stresses, that the main aim of a recovery plan is not the use of possibilities to install new taxes but to

⁴³ This could focus on economic sectors with special relevance to peripheral regions such as ship building, tourism, electronic industries, food production, and construction of wooden homes. The West Estonian archipelago representatives are thinking about the introduction of a tourism tax.

⁴⁴ See section 32 of the Local Government Financial Management Act.

⁴⁵ See sections 32-35, 39-41 as well as 42-52 of the above-mentioned Act.

⁴⁶ See section 47 of the above-mentioned Act.

downsize expenditure. In this line, the rapporteurs have doubts whether giving tax increase powers to local governments will be consistent with the social realities in financially weak local authorities. If the GDP per capita in these units is under average, measures to increase the tax pressure will probably not help to increase local revenues. The rapporteurs insofar agree with the government, that structural problems of some local governments cannot be solved by increasing local taxes.

52. The financial and economic crisis of 2008 along with important industrial reconversion needs, particularly in the north-eastern regions of Estonia, have had negative consequences for a number of local authorities when it comes to balancing their local budgets. Section 48 of the State Budget Act introduces a system of special aids to local authorities in particular financial difficulty.⁴⁷ The link between this support scheme and the Local Administration Financial Management Act may be found in section 50 of the latter act.⁴⁸ It is important to note that the Ministry of Finance has the discretion to decide whether an individual local authority is “unable to comply with the recovery plan or not”. Concerning section 47 of the State Budget Act, the funding of this scheme is determined within the annual state budget, and therefore the central government has general political discretion to decide whether the support scheme should be used or not and what expenditure should be assigned to the support scheme. It cannot be denied that the financial situation of local authorities has improved. The Minister of Public Administration in functions⁴⁹ reported that in autumn 2016 only one local government was affected by a risk of difficult financial situation⁵⁰ because it had not fulfilled the financial discipline rules set at state level. The Minister was optimistic that this situation would not worsen in the future.

53. In this context, the question of financial supervision of local budgets is relevant. In 2010 the Local Government Financial Management Act (LGFMA) was adopted, which lays down measures for local government to ensure financial discipline. The measures provided for in the LGFMA to ensure financial discipline are the following.

- The operating result, as at the end of an accounting year, shall not be lower than zero.
- At the end of an accounting year, the net debt may amount to six times the difference between the operating revenue and the operating expenditure of the accounting year ended, but shall not exceed the total operating revenue of the same accounting year.

With regard to budget discipline, local authorities must follow a two- step approach: a correction plan is used, when local governments do not follow the net cap of borrowing. A recovery plan is implemented when local governments are unable to fulfil their tasks. There might be cases where chapters 8 and 9 of Local Government financial management acts are merged into one. If local governments are not capable of preparing or fulfilling the goals the following plan is prepared under state supervision. The state can suspend income tax and equalisation fund transfers in the event that local authorities do not make a proper effort to solve their financial difficulties. All these measures are within the competence of the Ministry of Finance. Although the National Audit Office has audited local authorities’ budgets in recent years, including the budget of the city of Tallinn, the competence of the National Audit Office does not cover the use of any mechanisms in the event that a local authority finds itself in an economically difficult situation. The National Audit Office would be in favour of effective internal audit schemes at local government level, but the existence of internal audit mechanisms is not mandatory for local authorities.

47 See section 48 “Support fund” of the State Budget Act.

48 See **section 50** “Failure to implement recovery plan” of the Local Administration Financial Management Act.

49 See footnote 16

50 See section 42 “Risk of difficult financial situation” of Chapter 9 of the Local Administration Financial Management Act.

4.4 *Respect for the connectivity principle*

54. Article 154 (2) of the Estonian Constitution is very clear: “Duties may be imposed on a local government only pursuant to law or by agreement with the local government. Expenditure related to duties of the state imposed by law on a local government shall be funded from the state budget.”

55. According to the Minister of Public Administration in functions⁵¹, there have been no large waves of delegating tasks from the central to the local level. There are a few examples in the social sector including social support payments (for example, caregiver support and family support both with sufficient funding in local government budgets) and registration of births and deaths, among others. In his opinion, all of the tasks that have been transferred from the state to municipalities have been covered by state funding transfers in the same amount as the functions' cost to the state. He maintained that this principle will be respected during the municipal reform. Under this reform project the former government had planned for the transfer of tasks concerning county development planning, supporting entrepreneurship and organising public transport as joint tasks with effect from 2018.

56. Concerning the criteria to be respected when delegating tasks to local authorities, the above-mentioned Supreme Court judgment⁵² reads as follows:

However, in addition to local government functions, local authorities also perform national duties (see point 52 above). According to the second sentence of subsection 154 (2) of the Constitution, duties may be imposed on local authorities either pursuant to law or by agreement with the local authority.

According to the second sentence of subsection 154 (2) of the Constitution, expenditure related to the duties of the state imposed on local authorities by law shall be funded from the state budget. The second sentence of subsection 154 (2) of the Constitution grants local authorities the right to funding of state-imposed duties of the state from the state budget. The state is obligated to finance national duties imposed on local authorities.

57. In addition, a standing order of Parliament obliges the government to indicate the financial impacts of a reform bill in the explanatory memorandum of the draft Act.⁵³ The positions of the state and local government often differ concerning decisions as to whether local authorities receive the additional resources they need to exercise new additional tasks assigned to them by the national government.

58. The Supreme Court judgment of 28 October 2016 (3-4-1-26-14) was mentioned to the rapporteurs. This decision states that the “withholding of legal acts providing financing from the state budget of the settlement tasks laid upon local government by the Private Schools Act is unconstitutional”. Several opinions from the Association of Estonian Cities were collected about the drafts, in which, according to the association, the connectivity principle was not respected by the government when the drafts were presented to parliament:

- Social Welfare Act (RT I, 30 December 2015, 5; 18 July 2016, 1)
- Basic Schools and Upper Secondary Schools Act Amendment Act (RT I, 31 December 2015, 11)
- Building Code (RT I, 5 March 2015, 1 ... 5 June 2016, 3)
- Planning Act (RT I, 26 February 2015, 3 ... 21 June 2016, 1)
- Basic Schools and Upper Secondary Schools Act and Private Schools Act Amendment Act (RT I, 11 March 2015, 3)
- Private Schools Act, Youth Work Act and Basic Schools and Upper Secondary Schools Act Amendment Act (RT I, 16 June 2016, 1)
- Environmental Charges Act Amendment Act (RT I, 5 July 2016, 2).

59. Representatives of local authorities met during the monitoring visit also mentioned to the rapporteurs the obligation of local authorities to pay teachers' salaries, starting from 2002, without sufficient compensation. This could be of particular financial relevance in future, because the new “Basic Principles” provide for additional expenditure in the education sector.⁵⁴ Another criticism is linked to the Social Welfare Act: a committee to deal with under-age children has been abolished and

⁵¹ See footnote 16

⁵² See Supreme Court Judgement 3-4-1-8-09 from 2010.

⁵³ See section 103 of the Riigikogu Rules of Procedure and Internal Rules Act, [RT I 2007, 44, 316 - entry into force 14 July 2007].

⁵⁴ See Chapter IV “Education and Research Policy” of “Basic Principles of the Government Coalition between the Estonian Centre Party, the Estonian Social Democratic Party, and Pro Patria and Res Publica Union (IRL) for 2016-2019”

according to the representatives “the power remains, the money is gone”. As regards the requirements of pupils with special needs representatives of local authorities were worried that special structures – financed by the state – might be abolished and local authorities would incur additional expenditure when these pupils are integrated into the ordinary school system. During the consultation process, the Ministry of Finance has informed the rapporteurs that children with disabilities receive larger capitation fees and the state provides special services for them. The rapporteurs believe that the connectivity principle must be applicable not only if new powers are delegated to local authorities, but also when existing powers and competencies are amended, if these amendments increase expenditure at local level.

60. The rapporteurs welcome the amendment of section 46 of the State Budget Act. The new negotiation process in section 46, paragraphs 2-4, of the State Budget Act may, in general, be suitable to guarantee sufficient transparency as to the financial impact of reform measures, to give local authority representatives plenty of opportunity to present their arguments and to ensure the correct recording of the negotiations. A missing element may be the procedural issue as to which deadlines have to be respected by the government when starting the negotiation procedure under section 46 of the State Budget Act. The rapporteurs believe that, apart from the exceptional case of urgent procedures, local authorities should have at least one month to prepare their position.

5. STATE REFORM, REGIONAL GOVERNMENT ASPECTS, INTERMUNICIPAL AND INTERREGIONAL CO-OPERATION

61. Estonia has 15 counties, which are deconcentrated state administration units that have a governor as head of the county administration,⁵⁵ as well as a number of different state agencies with specialised targets. The counties differ considerably in population and size. Their population varies from approximately 9500 inhabitants (Hiiumaa County) to approximately 602 000 (Harjumaa County). The surface area ranges from 989 square kilometres (Hiiumaa County) to 4807 square kilometres (Pärnumaa County). A county has a dual function: it is a state agency and at the same time it represents the interests of the county (including the local authorities within the borders of the county) vis-à-vis the national government.

62. Estonia has decided not to introduce a two-tier local self-government system, but to instead reorganise the second level of public administration as a state function, although there have been various proposals to install a real two-tier local administration system in Estonia. There is evidence that the existing model of regional administration is in need of substantial reorganisation. The new government coalition decided to adopt a “low budget” approach. Chapter 3, point 4, of the “Basic Principles” contains the following proposition: “We will abolish county governments, transferring their essentially local-government functions to local governments and their joint organisations, and their state monitoring functions to state agencies. We will relocate state agencies to various counties.” In fact, details of this reform are not known and it is not clear which “essentially local-government functions” should be transferred to local authorities. In order to obtain detailed answers, a full review of the tasks of administrative units at the existing county level seems necessary.⁵⁶ Nevertheless, local authority associations are in favour of such a reform. They have proposed that county administration tasks should be given to the municipalities and second-level local authorities should not be formed. After the monitoring visit the Ministry of Finance informed the delegation that the abolishment of County governments would be completed by 1 January 2018.

⁵⁵ The legal basis of the county structure is to be found in the Territory of Estonia Administrative Division Act, passed on 22 February 1995, RT I 1995, 29, 356, Entry into force 27 March 1995, partially 01 September 1995. a. See Section 2. “Administrative division of territory of Estonia”.

⁵⁶ The Chancellor of Justice mentioned this issue in her opinion to the Supreme Court during the review proceedings relating to the Administrative Reform Act. The Court has asked the central government to provide clear evidence about which are local and which are state tasks. The government has made an analysis in response to this question.

63. According to the information provided by the Minister of Public Administration in functions⁵⁷, the former government developed some guidelines that will be helpful when analysing the direction of reforms at the state administration level in future. The population of Estonia is decreasing and there is a need to make state governance leaner and more efficient. This means a smaller workforce, less bureaucracy and more e-services. State government reform includes the redesigning of public services: minimising duplication between agencies; maximum use of e-solutions; reducing bureaucracy; further consolidation of state support services; and outsourcing to the private sector. The minister has developed a number of projects supporting the reform.

64. **Analysis of state functions** – State functions were analysed focusing on a variety of areas where changes can be initially made. The government oversees the reorganisation's results on a periodical basis and decides which projects should be done next. The co-ordinating body is the Ministry of Finance, but all projects are carried out in close co-operation with other ministries.

65. **Zero Bureaucracy project** – Firstly, entrepreneurs were consulted concerning their communication difficulties with the state and to obtain their proposals for reducing bureaucracy. Overall, 252 proposals were received from entrepreneurs on cutting bureaucracy in communications between the private and the public sector. The second stage of the zero bureaucracy project was addressed to state authorities and aimed to find out how bureaucracy within the state could be reduced in everyday internal communications. In total, 963 proposals were received.

66. **Consolidation of state support services** – Reorganisation already started in 2009. The aim is to implement:

- one personnel and payroll accounting software (SAP) for all state agencies (253);
- one service point for personnel and payroll accounting at least in every ministry for the area of government concerned (state authorities or agencies) and one central service point – the State Support Service Centre;
- a self-service portal for employees to send or get their own information (e-documents);
- a web-based reporting system.

By the end of 2017, all state agencies will be using one personnel and payroll accounting software and most state agencies will be using the services of the State Support Service Centre. The only exceptions will be the army and intelligence services.

67. **County government reform** – Based on the analysis of state functions, the Minister of Finance has proposed to reorganise county governments by closing down county governors' administrations and to delegate these functions to the ministries, agencies and municipalities. Some regional development functions could be given to the new regional agency which is responsible for regional planning and coherence between the central government and local levels. The political decision to close down county governments and form a regional agency has not yet been made; discussions have been taking place within the government since last summer and will continue in the upcoming months.

68. **State house project** – At the service interface, these can be "one-stop shops". The aim is to improve the accessibility of state-level services, rationalise the use of state real estate at county level and be more citizen-focused in service provision. The project creates the possibility of merging all local state bodies (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 sub-national level. The government has decided to pursue the project, and detailed action plans will be presented to them at the beginning of 2017.

69. The rapporteurs suggest linking the state administration reform, particularly at county level, which could prove very difficult in practice, to the results of the ongoing amalgamation process. There could be new local authority units congruent with existent counties. This would refer to the "one municipality – one county concept". It could be sensible to transfer a maximum of powers to the local level, especially when larger local units are able to build up efficient local administrations. On the other hand, the government could reflect on whether co-ordinating and monitoring tasks, as well as legal supervision over local authorities, would be better executed through competent state-level ministries

⁵⁷ See footnote 16.

instead of through reorganised county units.

70. With regard to the intermunicipal and interregional relations of Estonian local authorities, these authorities have the right to co-operate with all other local authorities outside Estonia.⁵⁸ EU programmes support interregional contacts both with EU member states and with third countries. According to the Minister of Public Administration in functions⁵⁹, co-operation with Russia at regional level is correct. Representatives of the city of Tallinn have mentioned some specific interregional projects between Tallinn and Finland that focus on the transport sector.⁶⁰

6. THE ESTONIAN E-GOVERNMENT CONCEPT⁶¹

71. Estonia has started to build up efficient e-government facilities and adopted a broad series of special laws to support the transition from the classic state and local government structures and procedures to modern internet based administrations, with a view not only to using modern ICT technologies, but also to reducing state administration expenditure.⁶² Estonia has pioneered a series of technological reforms aimed at not only bringing everyone online but also creating a national database. The system is built around the online ID card,⁶³ introduced in 2002, with citizens' information – from healthcare records to tax filings, and from educational qualifications to real estate documents, to name but a few examples – stored in a seamlessly integrated national database.⁶⁴ This system is also to be used by local authorities.⁶⁵

72. The Estonian e-government concept has been commented on by the IMF⁶⁶ as being “conducive to growth”⁶⁷ and creates an “extremely business friendly environment”. The new government will continue pursuing an up-to-date Estonian e-government policy and has set targets with respect to e-government instruments in various parts of the “Basic Principles”.⁶⁸ In addition, the state has developed several e-democracy applications in co-operation with local authorities, to be used by the latter. Since citizens can, in many cases, communicate with the state using e-services (<https://www.eesti.ee/eng/services>), they expect the same from local authorities.

73. The local government associations support these policies. According to them, the new technology can effectively address and solve some of the common problems of local democracy, such as limited access to public information, limited possibilities for citizens to be involved in policy planning and planning city budgets, etc. Technology also helps to increase transparency in the political and administrative processes of local government. It offers new and innovative ways (methods and tools) of involving citizens in local decision-making processes, including the use of e-voting in local elections⁶⁹ (since 2005).⁷⁰ The associations have hired in common a number of IT specialists who co-ordinate ICT development, including developing the existing and new e-services for local authorities in Estonia. This service is partly financed by the Ministry of Finance (Minister of Public Administration) as it is also in the state's interest that municipalities, which generally lag behind in offering online services, are more capable of using them. According to the Ministry of Finance the state has created and supported local ICT since 2007. With regard to external analysis of the implementation of IT technologies at local level, the OECD recommends improving state policies in

58 See section 13 of the Local Government Organisation Act, Passed 02 June 1993, RT I 1993, 37, 558

59 See footnote 16.

60 See FinEst Link project (Finland-Estonia Transport Link) - funded by the Central Baltic Programme, which began on 1 August 2016 and will last for 24 months (total budget 1.3 million euros); FinEst Smart Mobility (funding from the Central Baltic Programme, began on 1 September 2016, for 36 months, with the total budget of 1.8 million euros); NSB Core project (North Sea Baltic Connector of Regions (funded by the Interreg Baltic Sea Region Programme, began on 1 May 2016 for 36 months, with the total budget of 3.5 million euros, implemented by a 16-member consortium, including Helsinki and Tallinn).

61 Various relevant materials are available in English at <http://www.ega.ee/et/sundmused/>

62 See www.fin.ee/estonian-public-service-annual-report/

63 Evidently, about 600 000 out of 1.3 Million inhabitants are using the system, which allows online access to all relevant public services.

64 More practical information under: <https://e-estonia.com/e-residents/about/>

65 See “Estonia launches OpenData application for municipalities” at <https://e-estonia.com/estonia-launches-opendata-application-municipalities/>

66 See IMF Country Report No. 15/336 REPUBLIC OF ESTONIA.

67 According to representatives from e-Estonia, the digital signature is saving an equivalent to 2.3% of the country's GNP.

68 Chapter II “Economic Policy, State Investments and Taxation”, points 3-4, 19c, point 21e,

Chapter 3 point 10, Chapter IV point 16 of the “Basic Principles of the Government Coalition between the Estonian Centre Party, the Estonian Social Democratic Party, and Pro Patria and Res Publica Union (IRL) for 2016-2019”

69 <http://vvk.ee/voting-methods-in-estonia/>

70 E-voting systems must be completely transparent and the results must be trackable, otherwise they may be open to attack from foreign secret services. Therefore, the protection of sensitive data must be guaranteed.

this sector:

(Recommendation 6): Estonia should aim to **strengthen the incentives and capacities for local councils' ICT adoption**. This can be done through support for the development of a relevant digital agenda for local government in Estonia; through jointly developing shared services and infrastructures; and through mobilising and partnering with the associations of local governments, helping them become competency centres for local ICT agenda development and execution.⁷¹

74. Bigger cities have put in place specific IT development strategies similar to the national approach. For example, Tallinn is benefitting from the smart IT infrastructure developed by the Estonian state; the ID card, X-road and digital signature, among other developments, are the main pillars of the city's modern IT solutions. Tallinn has approved the City IT Development Strategy setting itself an ambitious goal – to be, in their own words, a “Smart City”.

75. Local authorities have to invest in technical infrastructure. In Tallinn more than 300 wireless internet hotspots are available, some of which are maintained by the city. They are made available to residents free of charge. There are several aims to this scheme, including saving time for citizens when they interact with local public administrations. Access to different local services must be made easier, because in Tallinn more than 560 public services are in use. Many of them have been developed as fully automatized information systems where people's requests are processed in co-ordination with other state or city information systems and databases. As a result, the time spent on accessing the service has reduced dramatically.

7. CAPITAL CITY STATUS

76. One of the Congress' recommendations in 2010 was to give a special status to the capital city of Tallinn. This did not raise particular concerns either among the representatives of Tallinn and the associations, or with the minister. The issue is whether the special “capital city costs” are compensated by the central government. According to the city's representatives, there are no agreements and the costs are not compensated.

8. ANALYSIS OF THE SITUATION OF LOCAL DEMOCRACY ON AN ARTICLE BY ARTICLE BASIS

8.1 Principle and concept of local self-government (Articles 2 and 3)

Article 2 – Constitutional and legal foundation for local self-government

The principle of local self-government shall be recognised in domestic legislation, and where practicable in the constitution.

77. Article 2 of the Charter requires signatory countries to recognise the principle of local self-government in their domestic legislation or constitution. Overall, the rapporteurs consider that this Charter provision is reflected in the Estonian Constitution. Nevertheless, there may be a constitutional and legislative margin to increase legal protection of local self-government principles, as well as to improve continuity of central state politics towards local self-governments.

71 OECD Public Governance Reviews: ESTONIA © OECD 2015, page 21, Box 5. Summary of recommendations on digital government to support wider public sector reform in Estonia
<http://www.oecd.org/estonia/oecdpublicgovernancereviews-estoniataowardsasinglegovernmentapproach.htm#es>.

78. In Estonia, the relevant constitutional provisions (Chapter XIV) do meet this requirement of the Charter; Article 154, paragraph 1, stipulates that “all local issues shall be resolved and managed by local governments, which shall operate independently pursuant to law”.⁷² Details are regulated in particular in the Local Government Organisation Act, the Local Government Financial Management Act and the Local Government Council Election Act.

79. In this context, Article 3 of the Constitution gives an indication as to what extent principles and rules of international law are part of the Estonian legal system. According to section 2 of the ECLSG Ratification Act, the Republic of Estonia undertakes to follow all the articles of the Charter in the territory subject to its jurisdiction. The Charter sets out the minimum requirements that the state must keep in mind when organising local self-government, including when deciding funding for local authorities. Therefore, the Court *en banc* has held that the Charter plays an important role in interpreting the provisions of the Constitution concerning the organisation of local self-government and “in principle ... generally recognized principles and rules of international law are directly applicable in [the] Estonian legal system. These rules can be relied upon in Estonian courts”. This also would apply to the European Charter of Local Self-Government.⁷³ In accordance with Article 123 (2) of the Constitution when laws or other legislation of Estonia are in conflict with an international treaty ratified by the *Riigikogu*, the provisions of the international treaty apply.

8.2 Concept of local self-government (Article 3)

Article 3 – Concept of local self-government

- 1 Local self-government denotes the right and the ability of local authorities, within the limits of the law, to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population.
- 2 This right shall be exercised by councils or assemblies composed of members freely elected by secret ballot on the basis of direct, equal, universal suffrage, and which may possess executive organs responsible to them. This provision shall in no way affect recourse to assemblies of citizens, referendums or any other form of direct citizen participation where it is permitted by statute.

80. Article 3 of the Charter requires that local authorities must have “a substantial share of public affairs under their own responsibility”. Although the Charter does not specify which tasks and functions must fall within the competence of local authorities, the latter should primarily regulate and administer those public affairs that affect the majority of the local community and can be effectively carried out by local authorities.

81. Article 154 (1) of the Estonian Constitution stipulates that “All local matters are determined and administered by local authorities, who discharge their duties autonomously in accordance with the law.” The details are set out in section 2 of the Local Government Organisation Act:

Local government is the right, authority and duty of the democratically formed bodies of power of a local authority provided for in the Constitution, a rural municipality or city, to independently organise and manage local issues pursuant to law and based on the legitimate needs and interests of the residents of the rural municipality or city, and considering the specific development of the rural municipality or city. 2) Local government is: - based on the division of the territory of the state into administrative units; - exercised by democratically formed legislative and executive bodies and, with regard to local issues, by means of opinion polls or public initiative.

82. Representatives from various institutions and associations, together with local authorities, have underlined the need to clarify what are the mandatory tasks and functions of local government and how to differentiate between local affairs and state responsibilities. The Chancellor of Justice hinted that there is an on-going debate to clarify this issue and informed the rapporteurs that the question how to change domestic legislation to allocate a greater proportion of financial resources to local authorities is still being discussed as part of the on-going reform.⁷⁴ The rapporteurs point out that the Chancellor of Justice can act on her own initiative if she has a reason to believe that the legislation of general application is not in conformity with the constitution and laws.⁷⁵

⁷² <https://www.president.ee/en/republic-of-estonia/the-constitution/>

⁷³ See section 20 of the Constitutional Review Chamber of the Supreme Court, 15 July 2002, judgement No. 3-4-1-7-02 at <http://www.nc.ee/?id=428>

⁷⁴ Answers of the chancellor to the indicative list of questions No. 1.

⁷⁵ See Chapter I, Section 1 Duties of Chancellor of Justice, paragraph 1, of Chancellor of Justice Act, Passed

83. Another important issue has been raised by the National Audit Office when analysing the part of public affairs executed by local authorities. Should the distinction between state and local affairs be unclear, there is a risk that local authorities perform state functions at their own expense, instead of assigning costs directly to the competent state administration.

84. Concerning conformity with Article 3, paragraph 2, of the Charter, the rapporteurs have heard no criticism with respect to this provision, except for the Tallinn city representatives who criticised state legislation fixing the number of councillors to “no fewer than” 79 members.⁷⁶ In their opinion, the number of councillors is too high, particularly in comparison with the number of members of the Estonian Parliament (101). The rapporteurs concur with the starting point of the city, that all local (and state) institutions should be organised in such a way as to simultaneously permit optimum functionality and budget economy. With regard to the details, Article 154 of the Estonian Constitution refers to the national legislation, as well as Article 3 of the Charter. Therefore, the national legislature is free to organise the framework of local authorities’ activities and to set the number of local councillors.

85. Concerning Article 3, paragraph 2, of the Charter with respect to direct citizen participation, the rapporteurs refer to Chapter III, point 6, of the new government’s “Basic Principles” and support the government’s initiatives to strengthen all instruments of direct or indirect citizen participation at local and, if necessary, at state level.

86. The rapporteurs believe that, in general, Estonia is in line with the provisions of Article 3 of the Charter. However, they underline the need to strengthen local democracy with a clear distinction between state and local authorities’ powers. The government’s approach to strengthening local democracy through merged greater territorial units needs to be completed by strengthening local authorities’ powers and finances.

8.3 Scope of local self-government (Article 4)

Article 4 – Scope of local self-government

- 1 The basic powers and responsibilities of local authorities shall be prescribed by the constitution or by statute. However, this provision shall not prevent the attribution to local authorities of powers and responsibilities for specific purposes in accordance with the law.
- 2 Local authorities shall, within the limits of the law, have full discretion to exercise their initiative with regard to any matter which is not excluded from their competence nor assigned to any other authority.
- 3 Public responsibilities shall generally be exercised, in preference, by those authorities which are closest to the citizen. Allocation of responsibility to another authority should weigh up the extent and nature of the task and requirements of efficiency and economy.
- 4 Powers given to local authorities shall normally be full and exclusive. They may not be undermined or limited by another, central or regional, authority except as provided for by the law.
- 5 Where powers are delegated to them by a central or regional authority, local authorities shall, insofar as possible, be allowed discretion in adapting their exercise to local conditions.
- 6 Local authorities shall be consulted, insofar as possible, in due time and in an appropriate way in the planning and decision-making processes for all matters which concern them directly.

87. For the representatives of the associations and local authorities a key focus was the conformity of Estonian practice with Article 4, paragraph 2, of the Charter. In this respect, the rapporteurs believe that there could be room for improvement in Estonian legislation and practice. Different factors combine to limit “the full discretion of local authorities to exercise their initiative”. As mentioned above, a clear distinction between state and local affairs is missing. Secondly, bearing in mind that the state is currently streamlining the organisation of services of public interest at central level, local authorities expressed their concern that this would put an extra financial burden on local citizens and worsen the local business and living environment. Some examples have been presented to the rapporteurs: with respect to the reorganisation of driving education centres, the number of units throughout the territory was

25 February 1999, RT I 1999, 29, 406, Entry into force 01 June 1999.

⁷⁶ According to subsection 2 (5) of section 7 of the Local Government Council Election Act (LGCEA) (in force until 16 December 2008), the minimum membership of Tallinn City Council was no fewer than 63 members. According to the amendment of LGCEA that entered into force on 17 December 2008, the legislator increased the minimum membership of Tallinn City Council to at least 79 members (section 7, paragraph 2, No. 8 LGCEA).

reduced from 15 to 4. Such a measure is cost effective for the state but more expensive and time consuming for citizens. This would reduce the financial capacity of families and the discretion of local authorities to increase local taxes⁷⁷. Thirdly, Estonian local authorities are largely dependent on state budget allocations; their own resource potential is far too small to execute their tasks under Article 4, paragraph 2, of the Charter. The rapporteurs consider that Estonia is not in conformity with this provision.

88. Concerning Article 4, paragraph 3, of the Charter, the subsidiarity principle is largely accepted in the country's political practice as well as in the national jurisdiction. In its judgment of 16 January 2007, No. 3-4-1-9-06, the Supreme Court held that "the restriction of the local governments' guarantee, imposed by section 13 of the Building Act (which provides that local governments shall undertake to organize the building of public roads, public green zones, external lighting and rainwater pipes on the basis of a detailed spatial plan up to the boundary of a land unit specified in a building permit, unless the local government in question and the person requesting the preparation of the detailed spatial plan or the applicant for the building permit agree otherwise), is suitable for the achievement of the referred aim." As it is most expedient to ensure that this aim is achieved at local government level, the restriction is both necessary and in compliance with the principle of subsidiarity arising from Article 4, paragraph 3, of the Charter. Another judgment also referred to the applicability in Estonia of the principle of subsidiarity (Supreme Court judgment of 3 December 2007, No. 3-3-1-41-06).

89. With regard to Article 4, paragraph 4, of the Charter, the rapporteurs would like to advance the same considerations as in respect of paragraph 2. Accordingly, the implementation of this provision is, in practice, not fully guaranteed at local authority level.

The principles of consultation are laid down in the rules of the Government of the Republic of Estonia⁷⁸ in Estonian. These rules, particularly section 4 on co-operation and engagement and section 6 on co-ordination (concording), stipulate that the national associations of local government must be consulted when draft legislation is presented in parliament. In practical terms, the associations submit their comments on the draft laws via the e-law information system. The associations consider that, by and large, they have been duly informed and consulted about the new initiatives. At parliamentary level, we would mention the "Rule on Legal Technique of Drafts proceeded in Riigikogu". During the consultation process, the rapporteurs were informed by the Constitutional Committee of the Parliament that Riigikogu Rules of Procedure and Internal Rules Act had been amended on 13th of May 2016 (§ 36 section 2) so as to oblige the committee to invite those interest groups that were invited to participate in the preparation of the bill, to participate in the discussion of this bill.

90. The Administrative Procedure Act (2001) is of particular relevance, with regard to consulting local government as a party to various proceedings. Not holding hearings, when authorised to by law, is an essential procedural error that invalidates the respective state administrative act. With regard to the consultation procedures for changing local boundaries, Article 158 of the Constitution of the Republic of Estonia states that the boundaries of local authorities shall not be altered without taking into consideration local government entities' opinions. Section 46 of the State Budget Act establishes specific procedures with regard to consultation on the budget.⁷⁹

⁷⁷ During the consultation process, the Ministry of Finance has informed the rapporteurs that the reform of these services relates to the state sector and that the effects on local governments are less important as well as that the opening hours of the mentioned service are "consumer friendly" (see <https://www.mnt.ee/eng/organization/service-bureaus>) and most of the procedures can be done via electronic means through e-service (see: <https://eteenindus.mnt.ee/main.jsf>)

⁷⁸ <https://www.riigiteataja.ee/akt/119012011004?leiaKehtiv>

⁷⁹ See State Budget Act, section 46, subsection 2 at www.riigiteataja.ee/en/compare_original?id=504072014004

91. However, there seem to be some practical and organisational problems with the consultation procedure. The associations criticise the short deadlines allowed (normally a 15-working day consultation period is to be respected)⁸⁰ and stress the important point that draft bills may change in substance during the parliamentary deliberation process. Continuous consultation of the associations may be necessary but it is not always implemented, although the associations have been involved in the work of the reform committee. In general, consultations concentrate on practical aspects of a draft; local authorities are less included in the governmental discussions and decision-making processes on fundamental political issues. Particular criticism came from the associations with respect to the Administrative Reform Act; according to them, the government has not sufficiently communicated the overall aims of the reform.

92. The rapporteurs consider that Estonia formally respects Article 4, paragraph 6, of the Charter. However, consultation mechanisms could be improved. There should be more detailed information about mid- and long-term projects and their consequences for local authorities. Consultation practices should be adapted local authorities' need to closely follow deliberation processes. The government should not only organise the consultation process on a formal basis, in compliance with the criteria laid down in the Charter (in due time and in an appropriate way in the planning and decision-making processes for all matters which concern them directly), but the consultations should also take place on a regular basis. The rapporteurs are of the opinion that the consultation process between local authorities and the government should be globally improved in order to reinforce it.

93. To summarise these findings, the rapporteurs are of the opinion that non-compliance problems arise with the implementation of paragraphs 2 and 4 of Article 4.

8.4 Protection of boundaries

Article 5 – Protection of local authority boundaries

Changes in local authority boundaries shall not be made without prior consultation of the local communities concerned, possibly by means of a referendum where this is permitted by statute.

94. Article 158 of the Constitution of the Republic of Estonia requires that boundaries of local authorities shall not be altered “without considering the opinion of the local governments concerned”. In view of the ongoing reform project to amalgamate, on a large scale, the existing territorial units in Estonia, the aim of seeking the opinion of local authorities should be borne in mind. One of the interlocutors pointed out to the delegation “that local governments should protect the local government unit and provide coincidence of the state decision and public interest. The opinion of the local government unit should be profound and substantial and enable to clarify whether through border changes the wishful aim can be achieved. Such conclusion is confirmed by the fact that the Constitution does not exclude the border changes to be made against the will of the community”.

95. In this regard it is worth mentioning that the Supreme Court in its judgement of 20 December 2016, stated (point 136):

“Obligation to ascertain the opinion of residents does not proceed from § 158 of the Constitution. The Chamber is of an opinion that an obligation proceeds from § 158 of the Constitution for the executive power of the state to hear out the opinion of the local government unit. The Chamber notes that also the European Charter of Local Self-Government does not require the hearing out of the opinion of local residents. Article 5 of the Charter enacts: „Changes in local authority boundaries shall not be made without prior consultation of the local communities concerned, possibly by means of a referendum where this is permitted by statute.“ Thereby the Charter leaves it up to the accessed state to decide whether to organise a referendum which, pursuant to Estonian legal order, is of a binding nature, or a consultative referendum which, pursuant to Estonian legal order, does not have a binding legal force, or to delegate the expressing of residents opinion into the competence of the local government body”.

⁸⁰ See press release of the Association of Estonian Cities on 07 October 2015 (it was announced *inter alia* that the draft of the Basic Schools and Upper Secondary Schools Act presented by the Ministry of Education and Science, was not concerted by the association).

8.5 Administrative structures (Article 6)

Article 6 – Appropriate administrative structures and resources for the tasks of local authorities

- 1 Without prejudice to more general statutory provisions, local authorities shall be able to determine their own internal administrative structures in order to adapt them to local needs and ensure effective management.
- 2 The conditions of service of local government employees shall be such as to permit the recruitment of high-quality staff on the basis of merit and competence; to this end adequate training opportunities, remuneration and career prospects shall be provided.

96. Article 154, paragraph 1, of the Estonian Constitution stipulates that “all local issues shall be resolved and managed by local governments, which shall operate independently pursuant to law”. The organisational power of local authorities to decide how to manage local issues is itself a “local issue” and may be not restricted by the government. This right is restricted neither in this constitutional provision nor within the Local Government Organisation Act and other legal acts. In its judgment No. 3-4-1-12-09 the Supreme Court of Estonia gave some explanations concerning the principles ruling the internal organisation of local authorities, in particular: “The right of self-management is not an absolute right, yet the central authority of the state may interfere with the right only with such measures that are proportional and bear in mind a clearly defined lawful objective.”⁸¹

97. The rapporteurs have not heard any objections from representatives of local authorities with respect to a potential infringement of Article 6 of the Charter, with the exception of the above-mentioned criticism from the City of Tallinn concerning the number of council members. However, there has been repeated criticism with respect to the weak financial autonomy of local authorities, a fact which hinders them from building effective local administration structures, particularly in rural areas. According to the associations, quite often in smaller municipalities one employee covers different fields. As there is little work for specialists, since generalists are preferred, maintaining the quality of the staff is a challenge. Remuneration (and the volume of the budget) is comparable across municipalities that have a similar size. This topic will be dealt with under Article 9 of the Charter. In addition, the rapporteurs refer to Chapter VIII, point 2, of the “Basic Principles: “We will carry out an administrative reform to increase the decision power and responsibility of local governments in managing and organising public life.” As details are not yet known, the rapporteurs recommend reviewing these developments under Article 6 of the Charter at a later date.

98. With regard to the remuneration of local staff, the associations generally had no objections vis-à-vis the governmental instructions.⁸² Concerning the remuneration of teachers, who are local employees, the government has made use of earmarked grants for this purpose.

⁸¹ See the judgment of the Constitutional Review Chamber of the Supreme Court of 9 June 2009 in case No. 3-4-1-2-09, paragraph 32.

⁸² Local authorities are free to manage their human resources; there are no limits to remuneration set by the state. In rare cases, where the local authority is under state scrutiny (this happens when the municipality is, in real terms, in bankruptcy), the municipality has to adopt the recovery plan and the plan has to be presented to the Ministry of Finance. The Ministry can ask to modify the plan.

8.6 Local elected representatives

Article 7 – Conditions under which responsibilities at local level are exercised

- 1 The conditions of office of local elected representatives shall provide for free exercise of their functions.
- 2 They shall allow for appropriate financial compensation for expenses incurred in the exercise of the office in question as well as, where appropriate, compensation for loss of earnings or remuneration for work done and corresponding social welfare protection.
- 3 Any functions and activities which are deemed incompatible with the holding of local elective office shall be determined by statute or fundamental legal principles.

99. The rapporteurs heard no objections concerning the compatibility of Estonian rules and practices with Article 7 of the Charter. Details with respect to municipal councils are set out in Article 156 of the Constitution and Chapter 2 of the Local Government Organisation Act, as well as in the Municipal Council Election Act. Concerning remuneration, the details are set out in section 17, paragraph 3, of the Local Government Organisation Act.

100. The upcoming reform affecting the accumulation of mandates between local government membership and parliamentary membership is of particular concern. The associations are sceptic as to whether this reform project will improve local self-government. As already mentioned (see *supra* para.21), the Constitutional review proceeding against the law introducing the accumulation of mandates is currently pending before the Supreme Court of Estonia. The rapporteurs would like to refer to projects in other Council of Europe member states (for example, France) where the aim is to separate functions in the clear interest of preventing confusion between state and local affairs.

8.7 Exercising responsibilities and government supervision (Article 8)

Article 8 – Administrative supervision of local authorities' activities

- 1 Any administrative supervision of local authorities may only be exercised according to such procedures and in such cases as are provided for by the constitution or by statute.
- 2 Any administrative supervision of the activities of the local authorities shall normally aim only at ensuring compliance with the law and with constitutional principles. Administrative supervision may however be exercised with regard to expediency by higher-level authorities in respect of tasks the execution of which is delegated to local authorities.
- 3 Administrative supervision of local authorities shall be exercised in such a way as to ensure that the intervention of the controlling authority is kept in proportion to the importance of the interests which it is intended to protect.

101. With regard to the supervision of local authorities, the principle is laid down in Article 160 of the Constitution: "The administration of local governments and the supervision of their activities shall be provided by law." Details are set out in sections 66 and 66.1 of the Local Government Organisation Act. There are two main forms of supervision of municipalities. Internal supervision is carried out by the audit committee, the council and the Government (executive body of the local government). External supervision is carried out by the county governor,⁸³ the Chancellor of Justice and the National Audit Office. Administrative supervision over the activities of local governments is also exercised by ministries, boards and inspections (for example, Ministry of Finances, Data Protection Inspectorate, Language Inspectorate, Labour Inspectorate, etc). The main supervision functions have been described by the Minister of Public Administration in functions⁸⁴ as follows: the county governor has the right to monitor individual legislative measures of councils and local authorities. At the same time the county governor has no authority to stop or declare void any measures taken by local authorities; he/she can only suggest that the local authority take the necessary measures to comply with the law. If the municipality does nothing to bring the act into line with the law the county governor must appeal to the courts. The Chancellor of Justice reviews the local government regulations for conformity with the Constitution and the laws. The National Audit Office exercises economic control over local authorities insofar as they use immovable and movable property of the state which has been transferred into their possession; it also exercises control over

⁸³ Supervisory competence of the county governor in activities of local governments is regulated by section 85 of the [Government of the Republic Act](#).

⁸⁴ See footnote 16.

the municipal use of allocations for specific purposes, such as earmarked grants, and subsidies granted from the state budget; and funds allocated for the performance of state functions. The mandate of the National Audit Office also includes the audit of local authorities regarding the possession, use and disposal of municipal assets; the audit of the foundations and non-profit associations founded by a local authority or where a local authority is a member as well as of companies where a local authority exercises dominant influence through a majority holding or otherwise, and the subsidiaries of such companies. The National Audit Office verifies whether public funds have been properly used – i.e. economically, efficiently and effectively – and that their use is lawful. In order to avoid conflict with the principle of autonomy of local government, the National Audit Office may not, however, assess the expediency of the activities or use of funds by local authorities. In other words, the National Audit Office may not conduct performance audits of local authorities. The National Audit Office also has the right to make proposals to the government, ministers and local authorities to draft legislation or amend or modify legislation in force. The purpose of supervision is to ensure the lawfulness and appropriateness of municipal activities. The rapporteurs believe that the requirements of Article 8 are met in Estonia.

102. In order to interpret the scope of the legal limits of administrative supervision of local authorities, the Supreme Court of Estonia has referred directly to Article 8 of the Charter.⁸⁵ “To preserve the essence of the local authorities’ right to self-organisation the restriction thereof must be proportional, i.e. suitable for achievement of the desired aim, necessary and reasonable.” (See the Constitutional Review Chamber on the Supreme Court’s judgment of 16 January 2007 in case No. 3-4-1-9-06 – RT III 2007, 3, 19; paragraph 23). The same requirement concerning administrative control is expressed in Article 8(3) of the Charter. In this judgment the Court held that “the Charter does not preclude economic control over the state assets allocated to local governments in the extent described in § 6 of the NAOA, if the control is exercised - in conformity with Article 8(2) of the Charter – according to such procedures and in such cases as are provided for by the constitution or by statute”. However, with respect to the limitations of this aspect of control it deemed that the control of the use, possession and disposal of municipal property would be in conflict with the Charter. This possibility is not provided for in the National Audit Office Act.

103. With regard to the supervision of the upcoming administrative reform project, the Minister of Public Administration in functions⁸⁶ explained to the rapporteurs that during the voluntary phase there will be minimal supervision (limited to the legality of the proceedings) of the merging agreement and other decisions made by local councils in preparation for the reform. In addition to the legal supervision, the Minister of Public Administration is financing seven merger consultants to support all the municipalities interested in additional expertise. One of their roles is to support the preparation process and guarantee the inhabitants’ involvement in it. In the state-initiated phase there will be a larger – supportive, not supervisory - role for county governors, as in certain situations they will have lead the merger process. As the voluntary phase ends in early 2017, the state will initiate mergers in line with its regulation in mid-February, so that local government council elections can be held in October. During the process inhabitants will be polled and local authorities’ opinions will be obtained. The rapporteurs will follow with interest whether the new government will continue the former government’s supervision strategy or whether it will completely or partially change the administrative procedures.

⁸⁵ See section 4, paragraph 2, of the Constitutional Review Chamber of the Supreme Court Judgement, from 5 February 1998, judgement No. 3-4-1-1-98

⁸⁶ See footnote 16

8.8 Financial resources (Article 9)

9 - Financial resources of Local Authorities

- 1 Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.
- 2 Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.
- 3 Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.
- 4 The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.
- 5 The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility.
- 6 Local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them.
- 7 As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.
- 8 For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.

104. Concerning conformity with Article 9 of the Charter, the rapporteurs consider that there is significant room to improve the overall local finances system, not only the total amount of financial revenues and expenditures allocated to local authorities, but also with respect to the autonomy of own resources⁸⁷ and distribution procedures, including equalisation and the special support scheme. The rapporteurs refer to the Congress recommendation of 2010, where similar topics were already raised.⁸⁸

105. The rapporteurs acknowledge the important challenges that Estonia had to deal with following the international financial and economic crisis of 2008. These developments have certainly influenced the country's budgetary policy to a large extent, as well as financial intergovernmental relations and may confer legal discretion to vary state financial transfers to local authorities.⁸⁹ Although representatives from the state and the local levels may normally have a different perception of questions linked to the fair balancing of benefits and burdens, following external shocks to the economy and how to distribute the financial consequences between the levels of government, the rapporteurs consider that there has since been a significant economic and financial improvement at national level, which has certainly had positive effects on local finances but which, in addition, may have allowed room for a more expansive budgetary policy with particular relevance for local authorities' finances.

106. With respect to Article 9, paragraph 2, of the Charter, the difference in understanding of the compliance with the judgment of the Supreme Court of 2009⁹⁰ concerning the clear distinction necessary between state and local authorities' affairs should be mentioned. The government is of the opinion that there has been a sufficient evaluation of tasks and their clear distinction. The associations do not share this point of view. The rapporteurs refer to the spirit of the above-mentioned Supreme Court judgment that entails that a clear distinction between the state and local affairs is needed as this may also affect the financial situation of local governments. If there is a lack of clarification of the situation with respect to the allocation of competences, local authorities constantly run the risk of having to finance delegated state competences, although these competences must be financed completely by the state level directly or by earmarked transfers from the state level.

87 Vallo Olle, The Financial Guarantee of Local Government and Possibilities for its Protection (<http://www.juridicainternational.eu/index.php?id=14968>)

88 See paragraph 6.b, c, d e and f of Congress Recommendation 294(2010) on local democracy in Estonia

89 See section 68 of the Judgement of the Supreme Court from 16 March 2010, No. 3-4-1-8-09.

90 See the Judgement of the Supreme Court from 9 June 2009, No. 3-4-1-2-09

107. Concerning conformity with Article 9, paragraph 3, of the Charter, the table of local revenues for 2015 provided by the minister (see page 17) clearly shows that the tax revenues of local authorities are largely inadequate. The associations have pointed out that these taxes, namely, advertisement tax, tax for closing streets, motor vehicle tax, tax on keeping domestic animals, and parking fees represent about 1% of the revenues. This is not in line with the Charter.

108. The same finding is relevant for conformity with Article 9, paragraph 4, of the Charter.⁹¹ The Estonian system of financing local authorities is neither diversified nor evolutionary; there is excessive dependence on state grants and transfers.⁹² Even if an important share of personal income tax (which represents about 50% of the local revenues) is transferred to local authorities (according to Article 5 of the Personal Income Tax law 11,6% from the total wage of taxpayer goes to local budgets and the rest of tax yield goes to state budgets), the tax yield is not legally shared between the levels. The state has discretion to fix the tax rate, the tax basis⁹³ and – within the yearly budget - the quota to be transferred from the state budget to local authorities. The proposed reforms of personal income tax will probably also have consequences for the local share.⁹⁴

109. Article 9, paragraph 5, of the Charter is only partially respected in Estonia. According to the Constitutional Judgment No. 3-4-1-8-09 of 16 March 2010: “Financial equalisation mechanisms or analogous measures must be applied in the defence of local authorities whose funds are smaller so as to balance the uneven division of the potential sources of revenue and expenditure between local authorities.” The state has adopted, in section 46 of the State Budget Act, instruments to organise vertical transfers to local authorities. Considering that in 2016, 173 municipalities out of 213 received financing from the equalisation fund, the €75 million allocation is not sufficient to cover the needs of local authorities. The rapporteurs suggest increasing the level of this fund – as was proposed by the Minister of Public Administration in functions⁹⁵ – and completely reviewing the system upon completion of the territorial reform process. There will be fewer local authority units which will perform better if the reform succeeds. Along with the reform projects set out in the “Basic Principles” aimed at strengthening local fiscal autonomy, there might be room for new vertical and horizontal instruments to improve the Estonian fiscal equalisation system.

110. The rapporteurs have already referred to section 46 of the State Budget Act, which contains specific procedures for negotiations between local authorities, associations and state representatives with respect to the budget. They recommend strengthening the position of the associations at the end of the negotiation process with a view to giving them more than a formal right to participate. In fact, very often at the end of negotiations, the minutes are signed merely to prove that the negotiations have taken place. In relation to negotiations, section 46 of the State Budget Law goes beyond Article 9, paragraph 6, of the Charter. This includes a real will on both sides to agree, in the negotiation process, upon core elements which affect local finances. The rapporteurs suggest that both the associations and the competent ministry develop a common negotiation scheme, which would cover the most important issues to be dealt with and would also be in line with the relevant EU legislation within the so-called two- and six-pack measures to improve financial stability at all levels of government.

111. With respect to Article 9, paragraph 7, the rapporteurs refer to the Supreme Court ruling No. 3-3-1-74-15 of 20 April 2016: “It appears from Article 9 (7) that project-based supports are not excluded but need to be avoided, if possible. Whereas it emerges out of Charter that local government’s freedom of activity can be restricted through ear-marked distribution of a large share of supports to carry out concrete projects, there is no such an influence, if such supports have insignificant relative importance in total revenues.” In conclusion, the Court states that earmarked funding is in compliance with Article 9, paragraph 7, of the Charter, even if such support measures do only “have insignificant relative importance in total revenues”. The rapporteurs believe that, when this criterion is respected, Estonia is in conformity with Article 9, paragraph 7, of the Charter.

91 See section 66 of the Supreme Court Judgement 3-4-1-8-09 from 16 March 2010.

92 See section 29 of the Supreme Court Judgement of 19 April 2004, No. 3-3-1-46-03, which might give more discretion to the government concerning the financial architecture of local self-government in Estonia.

93 During the consultation process, the Ministry of finance argued that according to the Personal Income Tax law, tax exemptions are applied to the state budget share and that the on-going tax reform and increase of threshold would not affect local government revenues

94 See Chapter II “Economic Policy, State Investments and Taxation” of the “Basic Principles of the Government Coalition between the Estonian Centre Party, the Estonian Social Democratic Party, and Pro Patria and Res Publica Union (IRL) for 2016-2019”

95 See footnote 16.

8.9 *Rights to associate (Article 10)*

Article 10 – Local authorities' right to associate

- 1 Local authorities shall be entitled, in exercising their powers, to co-operate and, within the framework of the law, to form consortia with other local authorities in order to carry out tasks of common interest.
- 2 The entitlement of local authorities to belong to an association for the protection and promotion of their common interests and to belong to an international association of local authorities shall be recognised in each State.
- 3 Local authorities shall be entitled, under such conditions as may be provided for by the law, to co-operate with their counterparts in other States.

112. The Charter requires signatory countries to entitle local governments “to co-operate and, within the framework of the law, to form consortia with other local authorities in order to carry out tasks of common interest”. The rapporteurs did not hear any remarks or criticism from representatives of local authorities and their associations with respect to this provision. Concerning the future of the two associations, there are obviously plans to reorganise the structure of representing local authorities in Estonia after the territorial reform has taken place.

8.10 *Legal protection of local governments (Articles 11)*

Article 11 – Legal protection of local self-government

Local authorities shall have the right of recourse to a judicial remedy in order to secure free exercise of their powers and respect for such principles of local self-government as are enshrined in the constitution or domestic legislation.

113. The Supreme Court has underlined the importance of judicial control to guarantee local self-government in Estonia.⁹⁶ The Chancellor of Justice told the rapporteurs that local authorities had always had the right to apply to an administrative court to obtain protection of their lawful rights with regard to application of the law or another act of a more general nature. The Constitutional Review Court Procedure Act of 2002 gave an additional effective remedy to local authorities to protect them directly against an act of a general nature, (including the law itself. According to the Act, local government councils may submit a request to the Supreme Court to declare an act which has been promulgated but which has not yet entered into force, or a regulation of the Government of the Republic or a minister which has not yet entered into force, to be in conflict with the Constitution or to repeal an Act which has entered into force, a regulation of the Government of the Republic or a minister, or a provision thereof, if it is in conflict with the constitutional guarantees of local government.

114. Bearing in mind the important, diversified and permanent jurisdiction of the Supreme Court concerning local self-government topics and the possibility for local authorities to turn to the President of the Republic (cases under Article 107 of the Constitution), the Chancellor of Justice (cases under Article 142 of the Constitution and control of conformity of international agreements with the Constitution), the National Audit Office, or the administrative courts (Article 152 of the Constitution) if they consider that there may be an infringement by state administrations with respect to the core guarantees of local self-government, the rapporteurs consider that Estonia is in conformity with Article 11 of the Charter .

⁹⁶ See section 71 of the Supreme Court *en banc* judgement from 16 March 2010, No. 3-4-1-8-09 and section 20 of the Supreme Court Judgement from 30 September 2009, No. 3-4-1-9-09.

8.11 Undertakings – reservations formulated by States (Article 12)

Article 12 – Undertakings

- 1 Each Party undertakes to consider itself bound by at least twenty paragraphs of Part I of the Charter, at least ten of which shall be selected from among the following paragraphs:
 - Article 2,
 - Article 3, paragraphs 1 and 2,
 - Article 4, paragraphs 1, 2 and 4,
 - Article 5,
 - Article 7, paragraph 1,
 - Article 8, paragraph 2,
 - Article 9, paragraphs 1, 2 and 3,
 - Article 10, paragraph 1,
 - Article 11.
- 2 Each Contracting State, when depositing its instrument of ratification, acceptance or approval, shall notify to the Secretary General of the Council of Europe of the paragraphs selected in accordance with the provisions of paragraph 1 of this article.
- 3 Any Party may, at any later time, notify the Secretary General that it considers itself bound by any paragraphs of this Charter which it has not already accepted under the terms of paragraph 1 of this article. Such undertakings subsequently given shall be deemed to be an integral part of the ratification, acceptance or approval of the Party so notifying, and shall have the same effect as from the first day of the month following the expiration of a period of three months after the date of the receipt of the notification by the Secretary General.

115. Estonia has not given notification of any reservations or declaration with respect to the Charter provisions.

9. THE ADDITIONAL PROTOCOL

116. On 16 November 2009, Estonia signed and on 20 April 2011, ratified the Additional Protocol to the European Charter of Local Self-Government on the right to participate in the affairs of a local authority (CETS No. 207), which entered into force on 1 June 2012. The Supreme Court has in different judgments accepted the Additional Protocol as a valid legal basis for controlling the constitutionality of Estonian laws.⁹⁷

10. CONCLUSIONS AND PROPOSALS

117. In general, the situation of local democracy in Estonia is positive. The country currently faces specific challenges, some of which are mentioned below.

- Estonia currently faces particular challenges in the context of European integration and foreign and defence policy.
- Estonia is pursuing the state reform process focusing on budgetary discipline, with the aim of reducing the expenditure of governmental and state structures and gaining efficiency through a strong shift to the use of e-government instruments.
- The heterogeneous territorial structure of local self-government units, which vary with regard to their size, financial and administrative capacities and political influence, as well as a considerable discrepancy between urban and rural local government units, is to be eliminated through a far-reaching mandatory territorial amalgamation process and an important reform of state structures.
- The ongoing need to strengthen the bureaucratic and financial stability of local authorities in the wake of the financial and economic crisis in 2008 is still the subject of political disagreements between state and local authority representatives.

⁹⁷ See judgement from 15 October 2013, No. 3-4-1-47-13: “The Constitutional Review Chamber finds that legal provision in the Local Government Election Act does not contradict to the Constitution, to the Additional Protocol to the ECLSG on the right to participate in the affairs of a local authority and to the International Convention on the Elimination of All Forms of Racial Discrimination.”

- The recent changes in the political colour of central government and the realignment of central political topics with local relevance, due to the political orientations of the new government coalition in office, will oblige the government to review the political cohesion of different policy measures vis-à-vis local authorities.

118. All these factors have obviously influenced Estonia's non-implementation or partial implementation of Congress Recommendation 294(2010). The rapporteurs have taken into consideration the fact that the financial and economic crisis of 2008 in particular obliged the Estonian authorities to review core concepts of their state organisation, as well as the structures of local self-government and intergovernmental relations between the state and local self-government units. The ongoing territorial reform process with the aim of creating local government units with at least 5000 residents is of extreme importance for the country and will influence many specific aspects of local self-government in the near future.

119. The new government is clearly ready to accept small adjustments within the reform process but firstly wishes to wait for the judgment of the Supreme Court on the constitutionality of the reform. The Supreme Court's constitutional review chamber handed down its decision on the Administrative Reform Act on 20 December 2016. During the consultation process, the Ministry of Finance informed the rapporteurs that as the Supreme Court did not declare any problems of constitutionality in the implementation of the Administrative Reform Act (except for its section 24, paragraph 1) by the new government, it could continue along the procedure adopted by the previous government.

120. The rapporteurs suggest linking the reform of the state administration, particularly at county level, which could be very difficult in practice, to the results of the ongoing amalgamation process. There could be new local authority units congruent with existent counties. This would refer to the "one municipality - one county concept". It could be sensible to transfer a maximum of powers to the local level, with concomitant finances, especially when larger local units are able to establish efficient local administrations. On the other hand, the government could consider whether the co-ordinating and monitoring tasks, as well as legal supervision over local authorities, would be better executed through the competent ministries at state level instead of through reorganised county units.

121. With respect to local finances, the rapporteurs heard a series of arguments. The main objections are: the limited autonomy of local authorities to introduce taxes as important local own resources; the increase in expenditure, particularly in the education, social work and infrastructure (local roads) sectors; dependence on state grants and transfers (particularly those organised through income tax); and the asymmetric development of revenues at state and local level. Clearly, there has been a degree of deterioration in the financial stability of local authorities in comparison with the situation before the 2008 financial crisis. At the very least, at central state level, there has been a higher increase in revenue and expenditure since 2009 than at local level. These trends may have caused a backlog in adapting local authorities' policies to the needs of the population. On the other hand, Estonian local authorities face similar difficulties to their counterparts in many other Council of Europe member states, where local taxation is concerned. Political representatives in local self-government units have not been very interested in introducing local taxes.

122. With regard to the need to increase financial equalisation, the rapporteurs note the ongoing amalgamation process and the important changes to the territorial structures of local self-government units. The rapporteurs consider it necessary to reflect on the core orientations of this fund after the completion of the territorial reform. It might be necessary to review the budgetary provisions in favour of equalisation, as well as the distribution criteria, if, even following mergers, local government units still lack the level of competitiveness necessary to cover the costs linked to the provision of local services due to specific extra charges arising from their peripheral, socioeconomic or geographical situation. Representatives from the West Estonian archipelago have proposed the idea of special tax regimes for peripheral regions; this may also need to be taken into consideration.

123. ICT plays an extraordinarily important role in Estonia – it is clearly regarded as a "special tool" in comparison with other European Union member states and should generate important competitive advantages in economic and demographic terms. The rapporteurs are convinced that all questions linked to the application of modern ICT systems in state and local administrations are also of particular importance for the further development of local democracy.

124. Concerning conformity with the Charter, the rapporteurs have made particular observations with respect to Articles 4, paragraphs 2 and 4, and 9, paragraphs 3-4, and possibly Article 9, paragraph 2, of the Charter. Partial compliance is noted with regard to Article 9, paragraph 5. There are some reservations (comments) for Articles 2, 3 paragraph 1, 4 paragraph 6 and 9 paragraph 6, although the rapporteurs consider that, in general, there is compliance with these articles.

APPENDIX – Programme of the Congress monitoring visit to Estonia

CONGRESS MONITORING VISIT TO ESTONIA
Tallinn, Jõhvi, Paide (06-08 September 2016)

Congress delegation:

Rapporteurs:

Mr Henrik HAMMAR
Rapporteur on local democracy
Chamber of Local Authorities, EPP/CCE⁹⁸
Member of the Monitoring Committee of the Congress
Member of the Örkelljunga Municipal Council (Sweden)

Mr Leen VERBEEK
Rapporteur on regional democracy
Chamber of Regions, SOC⁹⁹
Member of the Monitoring Committee of the Congress
King's Commissioner of Flevoland Province
(Netherlands)

Congress Secretariat:

Mr Romain PINCHON
Co-Secretary to the Monitoring Committee

Expert:

Mr Bernd SEMMELROGGEN
Member of the Group of Independent Experts on the
European Charter of Local Self-Government
(Germany)

Interpreters:

Mr Meelis LEESIK

Ms Karin SIBUL

The working language of the meeting will be Estonian. Interpretation from and into English will be provided.

⁹⁸ EPP/CCE: European People's party Group in the Congress

⁹⁹ SOC: Socialist Group in the Congress

**Tuesday 06 September 2016
Tallinn**

Independent Expert:

- **Dr Iur. Vallo OLLE**, Full member of the Group of Independent Experts on the European Charter of Local Self-Government

**Estonian Congress delegation;
Association of Estonian Cities (AEC) and
Association of Rural Municipalities of Estonia (ARME):**

• **Full members of the Estonian Delegation to the Congress:**

- **Mr Leo AADEL**, Head of the Estonian Delegation to the Congress, Mayor of Haljala Municipality
- **Mr Mihkel JUHKAMI**, Deputy Head of the Estonian Delegation to the Congress, Mayor of Rakvere City

• **Representatives of the Association of Estonian Cities (AEC):**

- **Mr Taavi AAS**, Chairman of the Board
- **Ms Pippi-Liis SIEMAN**, Vice-Chairman of the Board of the Association of Estonian Cities, Mayor of Türi Rural Municipality
- **Mr Vladimir ŠOKMAN**, Member of the Board of the Association of Estonian Cities, Vice-Mayor of City of Tartu
- **Mr Georg PELISAAR**, Member of the Board of the Association of Estonian Cities, Mayor of Põlva Rural Municipality
- **Ms Angelika KALLAKMAA-KAPSTA**, Consultant, Tallinn City Government, Member of the Cooperation Assembly of the national associations of local authorities of Estonia

• **Representatives of the Association of Rural Municipalities of Estonia (ARME):**

- **Mr Kurmet MÜÜRSEPP**, Chairman of the Board of the Association of Rural Municipalities of Estonia, Member of the Council of Antsla Rural Municipality
- **Mr Ivar TEDREMAA**, Vice-Chairman of the Board of the Association of Rural Municipalities of Estonia, Mayor of Kambja Rural Municipality
- **Mr Ott KASURI**, Executive Director of the Association of Rural Municipalities of Estonia

Tallinn City Government and Council:

- **Mr Taavi AAS**, Deputy Mayor, Mayor *a.i.*
- **Mr Kalev KALLO**, Chairman of the City Council
- **Mr Toomas SEPP**, City Secretary
- **Ms Angelika KALLAKMAA-KAPSTA**, Consultant, Tallinn City Government, Member of the Cooperation Assembly of the national associations of local authorities of Estonia

Parliament (*Riigikogu*):

- **Mr Eiki NESTOR**, President
- **Mr Kalle LAANET**, Chairman of the Constitutional Committee
- **Mr Remo HOLSMER**, Chairman of the Finance Committee

Chancellor of Justice (*Õiguskantsler*):

- **Ms Ülle MADISE**, Chancellor of Justice
- **Ms Liina LUST**, Adviser

National Audit Office (*Riigikontroll*):

- **Dr. Mr Alar KARIS**, Auditor General
- **Ms Airi MIKLI**, Director of Audit, Head of Local Governments' Audit Department
- **Mr Urmet LEE**, Director of Development

Wednesday 07 September 2016
Jõhvi, Tallinn

Ida-Viru County Local authorities:

- **Mr Aivar SURVA**, Mayor of Jõhvi City
- **Mr Veikko LUHALAID**, Chairman of the Board of the Union of Ida-Viru County Municipalities, Mayor of Vaivara Municipality
- **Ms Etti KAGAROV**, Vice-Chairman of the Board of the Union of Ida-Viru County Municipalities, Mayor of Kothla Municipality
- **Mr Raivo MURD**, Chairman of Narva-Jõesuu Municipality Council
- **Ms Jelena KORSUNOVA**, Chairman of Sillamäe City Council
- **Mr Viktor RAUAM**, Mayor of Lügánuse Municipality
- **Mr Tarmo TAMMISTE**, Mayor of Narva City

Ministry of Public Administration:

- **Mr Arto AAS**, Minister
- **Ms Kaia SARNET**, Deputy Secretary General for Regional Affairs
- **Mr Sulev LIIVIK**, Head of Local Governments Financial Management Department
- **Ms Ave VIKS**, Adviser of Regional Administration Department
- **Ms Olivia TALUSTE**, Adviser of Regional Development Department

Meeting with the Representatives of Baltic Estonian Islands:

- **Ms Reili RAND**, Mayor of Hiiu parish
- **Mr Madis KALLAS**, Chairman of the Saaremaa Local Governments Association
- **Mr Jüri SAAR**, Mayor of Pithla Municipality, Member of the Board of Saaremaa Local Governments Association
- **Mr Veiko VIIL**, Director of the Saaremaa Local Governments Association

**Thursday 08 September 2016
Paide, Tallinn**

Union of Järva County Municipalities:

- **Mr Veljo TAMMIK**, Mayor of Paide Parish, member of the Board
- **Ms Pipi-Liis SIEMANN**, Mayor of Türi Municipality, member of the Board
- **Mr Toomas TIPPI**, Managing director

Supreme Court:

- **Mr. Indrek KOOLMEISTER**, Justice of the Administrative Chamber of the Supreme Court