

# The Congress of Local and Regional Authorities



## Chamber of Local Authorities

**19<sup>th</sup> SESSION**  
**CPL(19)5**  
7 October 2010

## Local democracy in Estonia

Institutional Committee  
Rapporteur: Jos WIENEN, Netherlands (L, EPP/CD<sup>1</sup>)

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### *Summary*

This report considers the situation of local democracy in Estonia. It follows a monitoring visit conducted in 2000 and aims at assessing the action undertaken following the adoption of Recommendation 81(2000). It concludes that local democracy in Estonia has improved since the last monitoring report. The current recommendation points out to the Estonian authorities that there are certain issues that should, according to the delegation which carried out this visit, be subject to reform. These issues include granting special status to the city of Tallinn, revising national legislation in order to allocate to local authorities financial resources commensurate with the increasing responsibilities assigned to them, allowing local governments to raise local taxes to increase revenues and adapting the procedure of consultation of local and national associations, so as to conform to Article 4, paragraph 6 of the European Charter on Local Self-Government.

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<sup>1</sup>L: Chamber of Local Authorities / R: Chamber of Regions  
ILDG: Independent and Liberal Democrat Group of the Congress  
EPP/CD: European People's Party – Christian Democrats of the Congress  
SOC: Socialist Group of the Congress  
NR: Members not belonging to a Political Group of the Congress



## A. DRAFT RECOMMENDATION<sup>2</sup>

1. The Congress of Local and Regional Authorities, having regard to:

a. Article 2 para. 1b, of Statutory Resolution CM/Res(2007)6, which provides that one of the functions of the Congress is “to submit proposals to the Committee of Ministers in order to promote local and regional democracy”;

b. Article 2, paragraph 3 of Statutory Resolution CM/Res(2007)6, which provides 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 on Local Self-Government are implemented”;

c. Recommendation 81 (2000) on local democracy in Estonia;

d. Explanatory memorandum [CPL(19)5] on the situation of local democracy in Estonia, presented by Mr Jos Wielen;

2. Noting that:

a. Estonia became a member of the Council of Europe on 14 May 1993 and on 16 December 1994 ratified the European Charter on Local Self-Government (CETS No. 122, hereafter the Charter), which came into force in respect of Estonia on 1 April 1995, and signed the Additional Protocol to the European Charter on Local Self-Government on the right to participate in the affairs of a local authority (CETS No. 207) on 16 November 2009;

b. the Institutional Committee of the Congress appointed Mr Jos Wielen (Netherlands, L, EPP/CD) as rapporteur to prepare and submit a report on local democracy in Estonia;

c. Mr Wielen made an official visit to Estonia on 26 and 27 April 2010, accompanied by Mr Zoltán Szente, Consultant, Member of the Group of Independent Experts;

3. Thanks the Estonian Government and Parliament, the President of the Supreme Court, the mayors of Tallin and Haapsalu for the information provided and comments made during and after their meetings with the delegation, as well as the Estonian Congress delegation, its Secretariat and the representatives of the Estonian local authorities associations;

4. Welcomes the progress made on certain issues by the Estonian national authorities in accordance with Recommendation 81 (2000), such as the extension of the mandate of local government councils from three to four years, and the mergers of small local authorities on a voluntary basis;

5. However, the Congress stresses that some important parts of Recommendation 81 (2000) have to be reiterated.

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<sup>2</sup> Preliminary draft recommendation approved by the Institutional Committee of the Chamber of Local Authorities on 2 July 2010.

Members of the Committee of the Chamber of Local Authorities:

*E. Calota* (Chair), *M. Y. Barcina Angulo*, *J. Brons*, *M. Catovic*, *V. Chilikov* (alternate: *D. Ruseva*), *M. Cohen* (alternate: *I. Micallef*), *B. Collin-Langen*, *M. Cools*, *J. Costa* (alternate: *A. Torres Pereira*), *A.Ü. Erzen* (alternate: *G. Doganoglu*), *A. Gravells* (alternate: *N. Mermagen*), *M. Guégan*, *M. Gulevskiy* (alternate: *V. Belikov*), *G. Illes*, *W. Kelsch*, *O. Kidik*, *I. Kulichenko* (alternate: *Y. Kartashov*), *F. Lec*, *Y. Mischeriakov*, *L. O. Molin*, *J. Mrazek*, *A. Muzio* (alternate: *F. Pellegrini*), *C. Newbury*, *P.R. Paun-Jura* (alternate), *A. Rokofillou*, *B. Rope*, *M.G. Sassi*, *J. Wielen*, *E. Yeritsyan* (alternate), *D. Zmegac*.

N.B. : The names of members who took part in the vote are in italics.

Secretariat of the Committee: *S. Poirel*

6. *Therefore, the Congress recommends that the Committee of Ministers invite the Estonian authorities to:*

a. grant the city of Tallinn a special status, on the basis of Congress Recommendation 219 (2007), establishing different legal arrangements to take account of the particular situation of the capital compared with other municipalities;

b. clarify their legislation concerning the mandatory tasks and functions of local government;

c. change the domestic legislation urgently to allocate a greater proportion of financial resources for local authorities in order to make them commensurate with the responsibilities provided for by the Estonian Constitution and national law, and allow local authorities to raise revenues from local taxes. This change of the legislation was already urged in Recommendation 81 (2000);

d. take measures to ensure that local authorities receive adequate revenues from shared taxes, and that these are allocated in a transparent way;

e. set up a support fund for local authorities particularly affected by the economic crisis so that they are able to continue delivering certain social services;

f. start wide-ranging consultations with local authorities on the planned financial reform;

g. clarify the procedure of consultation with local authorities and national associations of local authorities in order to make consultations and discussion possible prior to the final decision making, as stated in Article 4, paragraph 6 of the Charter. This procedure should take place in due time and be organised in a proper manner before the discussion, in particular when a planned reform concerns local authorities or implies financial consequences for them;

h. encourage the Estonian authorities to ratify the Additional Protocol to the European Charter on Local Self-Government on the right to participate in the affairs of a local authority (CETS No. 207) as soon as possible.

## **B. EXPLANATORY MEMORANDUM**

### **Introduction**

1. Estonia signed the European Charter on Local Self-Government in 1994. The Charter is directly applicable in Estonia, as shown by a recent decision of the Estonian Supreme Court which referred to certain provisions of the Charter and identified them with some of the principles of the Estonian constitution (see below).

2. The Congress of Local and Regional Authorities of Europe, in the framework of its monitoring system, decided in 2000 to draw up a general report on the situation of local democracy in Estonia.<sup>3</sup>

3. The Congress' monitoring policy entails ongoing supervision of implementation of the Charter in member states, and the Congress therefore decided to produce a second general report in 2010. The reporting process provided an opportunity to follow up and investigate developments and changes that have taken place in the last ten years, as well as to check whether Estonia is complying with the principles and requirements of the Charter.

4. In May 2009, moreover, the head of the Estonian delegation to the Congress initiated a monitoring visit to Estonia in order to investigate whether the recent financial policy of the Estonian central government was in accordance with the provisions of the Charter.

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<sup>3</sup> CPL (7) 7 Part II

5. The Institutional Committee of the Congress, at its meeting in Utrecht (The Netherlands) on 15 February 2010, decided to send a delegation to Estonia to study the present situation of local democracy, as well as the circumstances surrounding certain recent controversial issues in the country.
6. Mr Jos Wiene (L, EPP/CD, Netherlands) was appointed rapporteur by the Institutional Committee on Estonia and replaced Mr Lars Molin (L, EPP/CD, Sweden), who was not available to participate in this visit. Mr Wiene had the assistance during the monitoring exercise of a consultant, Mr Zoltán Szente, a member of the Group of Independent Experts, and Mrs Stéphanie Poirel, acting secretary to the Institutional Committee of the Congress.
7. The monitoring visit took place on 26 and 27 April 2010, and the Congress delegation met representatives of the governmental authorities (Minister of Regional Affairs, Minister of Finance), the president of the Parliamentary Committee on Finance, the president of the Parliamentary Committee on Constitutional Affairs, the president of the Parliamentary Committee on Rural Affairs, the Chief Justice of the Estonian Supreme Court, members of the Estonian delegation to the Congress, representatives of the national associations of local authorities (Association of Cities of Estonia and Association of (Rural) Municipalities of Estonia), and the mayors and some other officials of the municipalities of Tallinn and Haapsalu (for the detailed programme of the visit please refer to Appendix 2).
8. The present report has been prepared on the basis of information and data collected during and after the visit and an analysis of all relevant Estonian legislation and other documents provided by the Estonian governmental authorities, the local government associations and the experts.
9. The delegation would like to thank the Estonian authorities, the national associations of local authorities and all the persons with whom discussions took place for their hospitality and their assistance with the organisation of the visit, as well as all those who helped to gather the information presented in the report.

## **I. General considerations**

### **1. Constitutional and legislative bases**

10. The Estonian Constitution of 1992 recognises the principle of local self-government, stating that “all local issues shall be resolved and managed by local authorities, which shall operate independently pursuant to law”. In addition, the Basic Law sets out the main guarantees of local authorities’ autonomy, stating that mandatory tasks may be imposed on local authorities only by law, or with the agreement of the local authority concerned. Local authorities exist only at municipal level; they are rural municipalities or towns. However, the Constitution does not exclude the establishment of other types of local authority, provided that the relevant legal procedure is followed.
11. The representative body of a local authority is the council, which has to be elected by secret ballot in a general, uniform and direct election.
12. The Constitution contains some provisions relating to the financial autonomy of local authorities, encompassing certain fundamental capacities, such as the capacity to have an independent budget and – within the limits of the law – the capacity to levy and collect taxes and to impose duties.
13. The boundaries of local authorities are constitutionally protected by a separate provision according to which the opinion of the local authorities concerned must be taken into consideration before any changes are made to their boundaries.
14. The arrangements for the supervision of local authorities are laid down by law.
15. There are other constitutional guarantees of local autonomy: for instance, every local authority has the right to form unions and joint agencies with other local authorities.

16. The major legislative texts are:

- the Local Government Organisation Act of 1993, determining the functions, responsibilities and organisation of local government and the relations of local authorities with one another and with state bodies;
- the Local Taxes Act of 1994, regulating local taxes, the procedure for the imposition of local taxes and the associated requirements;
- the Local Authority Council Election Act of 2002, on local elections and electoral procedure;
- the Rural Municipality and City Budgets Act of 1993, on the procedure for the preparation, adoption and implementation of rural municipality and city budgets;
- the Territory of Estonia Administrative Division Act of 1995, regulating the administrative division of the territory of Estonia, changes to administrative-territorial organisation, and the basis and procedure for changes to boundaries or to the names of administrative units.

## 2. Administrative structure of Estonia

17. Estonia has a one-tier local government system; local authorities exist only at municipal level. All the governmental authorities, representatives of local government associations and mayors interviewed explained this feature by referring to the small size of the country, making a regional level of government superfluous.

18. The country is divided into 15 regions known as counties, but these are regional agencies of the state administration and do not have elected councils. They are headed by county governors, who are appointed – after hearing the opinion of local government representatives – by central government. Until 1993 there were also county authorities with elected councils, but the Local Government Organisation Act abolished these. It should be noted that in 2000, the delegation was told of a number of proposals for the establishment of directly or indirectly elected county authorities in the place of the centrally controlled counties, but the delegation found during its monitoring mission of April 2010 that these proposals had been dropped. The problems which came to light ten years ago, namely that “[a] number of local government units are too small in size having insufficient financial and other resources to fulfil their tasks and functions properly”, and “[t]here are great differences between the smaller and the larger local authorities in their capacity to provide public services on the same level and quality” seemed to have been resolved in another way, namely by encouraging and carrying out voluntary mergers of smaller municipalities to form larger ones with more power.

**Table 1**

### Local authorities in terms of population size

Population	Cities	Rural municipalities	Total
0-1,000	1	37	38
1,001-1,500	2	47	49
1,501-2,000	2	31	33
2,001-3,000	1	29	30
3,001-4,000	4	13	17
4,001-5,000	3	12	15
5,001-7,500	5	15	20
7,501-10,000	2	4	6
10,001-20,000	8	5	13
20,001 – 50,000	2	–	2
50,001-100,000	2	–	2
100,001+	1	–	1
<b>Total</b>	<b>33</b>	<b>193</b>	<b>226</b>

19. The number of local authorities is not constant; in 2000, when the first report on Estonia was drawn up, there were still 247 local authorities (42 cities and 205 rural municipalities). Local authorities are allowed to merge on a voluntary basis. Such mergers are encouraged by the provision by central government of financial incentives for municipalities which merge. Until 2009, it was only in the years of local elections that mergers were allowed, a fact reflected in the table below.

**Table 2**

**Number of amalgamations and merged municipalities since 2002**

Year	Mergers	Merged municipalities	Number of local authorities after the mergers
2002	5	11	241
2005	8	22	227
2009	1	2	226

20. Since 2009, local authority mergers have also been possible in the period between local election years. As a result of these changes, there are currently 226 local authorities in Estonia, 33 of them cities and 193 rural municipalities.

### 3. Main powers and responsibilities of local authorities

21. The basic functions of local authorities are the independent organisation and management of local issues in pursuance of the law and on the basis of the legitimate needs and interests of the residents of the rural municipality or city, with consideration being given to the specific development of the rural municipality or city.

22. The Local Government Organisation Act reflects some of the fundamental principles of the European Charter of Local Self-Government, stating that local issues must be resolved independently and definitively by local authorities. Local authorities must take responsibility for fulfilling their functions. They provide public services for the local population on the most favourable terms.

23. More specifically, the tasks and functions of a local authority include the organisation of:

social assistance and services,

- welfare services for the elderly, disabled persons and children;

the maintenance of

- shelters, care homes, health care institutions,
- pre-school child care institutions,
- primary and secondary schools,
- libraries, community centres, museums, sports facilities;

the supply of

- housing and utilities,
- water and sewerage;

the provision of

- public services and amenities,
- waste management,
- spatial planning,
- public transportation within the rural municipality or city; and

the maintenance of rural municipality roads and city streets unless such functions are assigned by law to other organs.

24. Moreover, as a general rule, local authorities resolve and organise local issues which are assigned to them by other acts, and which are not assigned by law to other public authorities. Local authorities also fulfil central government functions assigned to them by law, as well as other tasks which arise from a contract between an authorised state body and a specific council.

25. The Local Government Organisation Act provides a number of powers for local authorities in order to fulfil their mandatory tasks and functions.

26. Some local government responsibilities relate to the democratic exercise of public power by the local authority. Thus local authorities may issue local decrees which are valid in the territory under their administration.

27. Rural municipalities and cities are legal persons under public law. The council, as the main decision-making body of a local authority, among others:

- approves the rural municipality's or city's development plans;
- submits its opinion about any alterations to rural municipality or city boundaries or changes to the names of rural municipalities or cities.

28. All local authorities also have wide-ranging powers to determine their own organisational structure. Moreover, each council elects its own chairman and deputy chairman, as well as the mayor of the rural municipality or city. It decides which committees to have and also elects their chairs.

29. Some powers are a basis for local authorities' financial autonomy. As a general principle, expenditure incurred by a local authority in performing its mandatory tasks and functions has to be met by the state budget. Furthermore, it is councils which, within the range of their exclusive responsibilities:

- decide on their local authorities' budget;
- impose local taxes and duties;
- manage local authority assets;
- decide whether to take out loans.

30. Local authorities exercise ownership rights over their municipal property.

31. Among councils' responsibilities is the delivery of a number of public services to their local population, as the delegation has already seen. For this purpose, local authorities have the right to establish local authority companies and foundations, or to participate in a company, foundation or non-profit-making association. They have the right to set up associations and joint agencies, as well as the right to engage in international co-operation with other local authorities.

32. In accordance with the European Charter on Local Self Government, the boundaries or name of a local authority cannot be altered unless the opinion of the council of the rural municipality or city concerned has been sought.

33. Local authorities have the right to apply to a court to obtain protection of their lawful rights or the resolution of disputes.

#### **4. Organisational structure and decision-making process of local authorities**

34. The major legislative body of the local authority is its council. The council comprises the local councillors, who are, as the delegation has seen, elected by secret ballot in a general, uniform and direct election. The number of local representatives depends on the size of the population of the municipality concerned.

35. Since 2005 councils have been elected for a four-year term in pursuance of the Local Authority Council Election Act (prior to that date, local elections had been held every three years).

36. Each council is headed by its chairperson, who manages the work of the council, convenes and chairs its sessions and represents the local authority and its council.

37. The council may set up committees on which its own members sit. While all local authorities are free to adopt the committee system that they wish, the establishment of an audit committee is compulsory in all municipalities.

38. The executive body of a local authority is its “government”, which is chaired by a mayor elected by the council. The detailed procedure for the formation of the government has to be regulated by statutes of the rural municipality or city. A rural municipality or city government prepares the issues to be included on the agenda for discussion by the council, and manages the local issues assigned to the government by council regulations or resolutions, or by the statutes of the rural municipality or city. It also manages local issues which do not fall within the remit of the council.

39. It is to be noted that the council has the right to pass a vote of censure against its own leaders (the chairperson or deputy chairperson of the council), as well as against its mayor and its government.

40. Every local authority has broad discretionary power to establish and manage public service institutions, including public corporations, in order to provide local services in a more effective way.

## **5. Central/local government relations**

41. Estonian administrative law, like the law in many other countries of Europe, makes a distinction between the two branches or spheres of public administration in the determination of the division of tasks between local authorities and state administration agencies. Nevertheless, this differentiation is not reflected rigidly in the organisational structure of Estonia’s public administration, since local authorities carry out a number of state administration tasks. This is not unusual in many Council of Europe member states, but the manner in which tasks and functions are distributed has caused problems in Estonia over the past few years. The core issue is the unclear definition of the nature of the mandatory tasks of local authorities, for there should be an unambiguous distinction between local authority and state administration functions. The practice of assigning mandatory tasks to local authorities is not in accordance with the European Charter on Local Self-Government, which makes a clear distinction between the “basic powers and responsibilities of local authorities”, which should “normally be full and exclusive”, and the functions “delegated” to them by a central or regional authority.

42. It is noteworthy that this method of assigning tasks has been also condemned by the Estonian Supreme Court which, in constitutional judgement No. 3-4-1-8-09, in 16 March 2010, deemed unconstitutional the failure to adopt proper legislation to “stipulate which obligations imposed on local authorities by law are of a local character and which are of a national character”. Until such time as the division of tasks and functions between the state administration and local authorities is clarified, it is impossible to comply with one of the basic principles of the Charter, namely that local authorities’ financial resources must be commensurate with their responsibilities. In this situation, as the Estonian Supreme Court’s decision also emphasises, it is vitally important for Estonia to improve its regulations governing the mandatory functions and financial resources of local authorities in the near future.<sup>4</sup>

43. The system and mechanism for central supervision of local authorities has not essentially changed since the first fact-finding visit in 2000. Legal supervision of local authorities is carried out by the Ministry of Internal Affairs, through the county governors, while the Chancellor of Justice supervises the conformity of local decrees and other higher-ranking laws. The State Audit Office inspects the management of state assets transferred to rural municipalities and cities.

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<sup>4</sup> The Congress delegation was informed that this subject is due to be discussed by the parliamentary parties in September 2010.



44. The supervision over local authorities exercised by central government extends to the lawfulness and usefulness of their activities. The supervisory bodies, in accordance with the law, have the right to suspend implementation of any decision to which an objection has been raised or to declare invalid a legal instrument of the local authority.

## 6. Local government associations and the procedure for consultations between central and local authorities

45. On the basis of their right of association, local authorities are allowed to co-operate with each other for the joint performance of mandatory tasks, such as public service delivery. The Local Government Organisation Act states that "Local authority units shall have the right to form associations and joint institutions together with other local authority units in accordance with the conditions and procedures established by the law. For representing, expressing, defending and performing joint tasks municipalities may: co-operate with each other, allow other rural municipalities or towns to act as proxies for them, and form leagues of local authority units." It is quite usual for neighbouring municipalities jointly to provide local public services in the fields of social care, health services or waste management.

46. On the basis of this same right of local authorities, they may also freely found or join associations with a view to better representation of their interests. At the moment, there are two national associations of local authorities, the Association of Estonian Cities and the Association of (Rural) Municipalities of Estonia. With a view to uniform representation of local authorities' interests vis-à-vis central government, interested associations run what is called the Local Government Associations Co-operation Assembly (LGACA). The central government usually consults the LGACA on the total local government budget before submitting the annual budget to parliament, requesting local government associations' opinion about any planned changes.

## 7. Local government finance

47. As the delegation has seen, the Constitution guarantees that local authorities have independent budgets. The whole local budget planning and approval procedure is regulated by the Rural Municipality and City Budgets Act. The Act requires local authorities to sustain a balance between income and expenditure.

48. The major financial sources of local authorities are central grants (block grants and capital grants), income from equalisation funds, local taxes, shared taxes and foreign aid (resources from EU funds).

49. The structure of local government income as a whole is as follows:

**Table 3**  
**The structure of local government income as a whole in 2009**

Types of income		Percentage
State taxes allocated to local budgets		60.50%
Personal income tax	54.96%	
Land tax	4.15%	
Environmental fees	1.38%	
Local taxes		0.88%
Equalisation funds		6.54%
Block grants		19.42%
Ring-fenced grants		1.12%
Foreign aid		11.54%
<b>Total:</b>		<b>100.00%</b>

50. As for central government (or budgetary support), it is worth noting that in 2004 a new system was introduced setting local authorities' share of personal income tax revenue as 11.4%. Subsequently this figure has risen to 11.9% of the total. Since local authorities' share of personal income tax revenue depends on central government, central support from the state budget is of great significance to local authorities' income base. This fairly centralised financial and taxation system does not leave local authorities much room for manoeuvre. Local taxes account for a very low proportion of total local government income and most municipalities have little chance of increasing their local tax revenues. Local governments have for example the right to impose land tax rate between 0.1 and 2.5%. As the delegation was informed during its visit to Estonia, local authorities do not have sufficient administrative capacity to levy local taxes, because it takes much administrative preparation to be in the position to collect the taxes. In many cases, the administrative costs of imposing new local taxes would exceed the revenues that could be expected from that source, or at least the revenue is comparatively too low, so the resulting costs and benefits would be out of balance.

51. In such financial circumstances, the income base of local authorities appears to be vulnerable, as is clear from the fact that one municipality has gone bankrupt and a few others came close to it in the past few years.

## 8. Other questions

52. The report on local democracy in Estonia written in 2000 concluded that the statutory requirement for proficiency in Estonian for anyone wishing to stand in local elections should be abolished, and that the legislative and governmental authorities should examine ways and means of protecting minority languages, including the right to use one's mother tongue at meetings of local authority councils. Since that time, considerable progress has been made in this respect. The current regulation on the use of language in local authorities states that, although the "working language of local authorities is Estonian", and the "sessions of councils and governments are held in Estonian", "[the] use of foreign languages in local authorities, including languages of national minorities shall be provided for in the Language Act". The Rapporteur was informed that proficiency in Estonian is no longer a requirement for anyone wishing to stand in local elections.

## II. The letter of complaint from the head of the Estonian delegation to the Congress

### Introduction

53. On 12 May 2009, Mrs Saima Kalev, head of the Estonian delegation to the Congress, sent a letter of complaint to the President of the Congress, in which she drew attention to the worsening financial situation of Estonian local authorities and proposed that the Congress initiate a monitoring process in order to investigate the state of local finances in Estonia and the implementation in that country of the principles of financial autonomy of local authorities laid down in the European Charter on Local Self-Government.<sup>5</sup>

54. Mr Keith Whitmore, Chair of the Institutional Committee, asked the Group of Independent Experts to examine the situation and to make a proposal for the next steps.<sup>6</sup> The Group instructed two experts to prepare a preliminary analysis on the issue<sup>7</sup>: Mr Sulev Mäeltsemees, who represents Estonia, who would inform the Group about recent developments and provide relevant information,<sup>8</sup> and Mr Zoltán Szente (Hungary), member of the Group, who had reported on the situation of local democracy in Estonia in 2000,

55. After the Group had decided to request more information from the Estonian authorities about the situation, the Estonian Government provided detailed information about the recent developments and the reasons underlying its financial policy, to which the Estonian delegation to the Congress had objected.<sup>9</sup>

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<sup>5</sup> CPL/BUR (16)7.

<sup>6</sup> CG/IC/fs.

<sup>7</sup> Information and opinion on the complaint of the Estonian delegation to the Congress.

<sup>8</sup> Short analysis of the current situation regarding the current state of local finances in Estonia.

<sup>9</sup> By letter of 12.10.2009.

56. The Institutional Committee, at its meeting in Utrecht in 15 February 2010, decided to draw up a general report on the situation of local democracy in Estonia, asking the rapporteur to examine the controversial issues, as well.

### **1. The effects of the central government's economic policy on local authorities' financial position**

57. The Estonian delegation's letter refers to certain economic restrictions imposed on local authorities by the recent legislation, which had considerably worsened the financial situation of Estonian local authorities. The letter of complaint implicitly argues that the Estonian authorities, in implementing their local authority finance policy, are in breach of Article 9 Section 2 of the European Charter on Local Self-Government, which provides that local authorities' resources shall be commensurate with their responsibilities, as well as of Section 6 of the same article, which requires that local authorities must be consulted, in an appropriate manner on the way in which redistributed resources are to be allocated to them.

58. The delegation investigated the recent changes made to local government finance. The delegation found that all parties involved in relations between central and local government recognise that Estonia is one of the European countries which have been most seriously affected by the 2008 global economic crisis. GDP fell by about 14% in 2009, and almost all national economic indicators declined.

59. In this situation, Estonia began to cut its national budget deficit and the growth of its national debt, action which is indispensable in order to ensure the financial stability of the country, as well as to comply with the so-called "Maastricht criteria" which have to be met by countries wishing to join the euro zone. Since the total local government deficit amounted to no less than 22% of the state deficit, the Government took preventive measures against local authority debt and national deficit growth. For this reason, the 2009 budget act was twice amended, considerably reducing government expenditure, and consequently local authorities' income base. Their share of personal income tax, for example, was cut from 11.93% to 11.40%, and a number of specific grants, such as subsidies for education, culture and road maintenance, were also reduced.

60. These measures severely affected local authorities' financial position: according to a National Audit Office (NAO) report, rural municipalities' and cities' income declined by nearly EEK (kroones) 2.5 billion, i.e. 11%, in 2009 as compared to 2008 at, from EEK 22.7 billion to EEK 20.2 billion.

61. Another law imposed a further restriction on borrowing, in order to keep the deficit of local authority budgets under control.

62. This reduction has had a serious effect on local budgets, because personal income tax revenues account for a large proportion of local, or "own", resources. The effect of the reduction in the percentage of personal income tax revenue was aggravated by the fact that the global economic crisis caused a fall in the total amount of income tax collected. A further disadvantage was caused to local budgets by the rise in value added tax and other taxes, bringing additional financial burdens for local authorities, a trend potentially dangerous to smaller or rural municipalities in particular, as they are unable to obtain extraordinary income to help to meet these extra costs.

63. In an effort to compensate for cuts in local authority budgets, a new law was passed by parliament which removed local authorities' obligation to support sport and youth work and relieved the obligation to provide kindergartens' services.. The delegation was nevertheless informed by the national associations of local authorities and by the representatives of local authorities whom it met that many local authorities cannot cease to deliver these local services, because they are under a contractual obligation to provide them, and would be unable to terminate the existing contracts unilaterally without providing compensation. These measures have not therefore resulted in actual cost reductions for the majority of local authorities

64. From the legal viewpoint, where implementation of the Charter in this specific case is concerned, consideration must be given to whether the financial burdens arising out of the economic crisis and the restrictive budgetary policy of central government in reaction to its financial difficulties are shared out among the various component parts of the state budget, or whether local authorities are bearing a disproportionate burden compared to other areas; consideration also needs to be given to whether cuts in local authority budgets are

jeopardising the performance of local authorities' mandatory tasks and functions, or how they are affecting the balance between the range of responsibilities and the resources provided for them.

65. The Charter does not impose on member states a specific system of local government finance, instead giving them great freedom to determine their own systems, and it does not require local authorities to be placed in any specific financial position. It might, however, be infringed if local authorities' income (be it from central grants or from own revenues) is reduced by large or significant amounts without any compensation or any corresponding reduction in their tasks and responsibilities. It is a basic requirement of the Charter that a balance be maintained between mandatory tasks and functions and the financial resources needed to fulfil these. According to the relevant provisions of the Charter, local authorities' resources must be commensurate with their responsibilities. Thus it is necessary to assess local authorities' capacity to carry out their mandatory tasks, i.e. whether or not they are able to perform their functions.

66. During its monitoring visit, the Congress delegation reached the conclusion that, although local authorities had suffered a great reduction in income for which they had received no real compensation, and were in a worsening financial situation, the relevant legislation did not render local authorities unable to fulfil their tasks or exercise their powers and did not place unreasonable or disproportionate burdens on local authorities. This is confirmed by the NAO report, according to which "[t]he NAO is of the opinion that many local authorities have reacted slowly to the changes in the economic environment. They have acknowledged and implemented with a delay the need to reduce expenditure, which is why they have significantly used funds collected over the previous years and due to this, local authorities face difficult choices in 2010 when revenue continues to decrease."

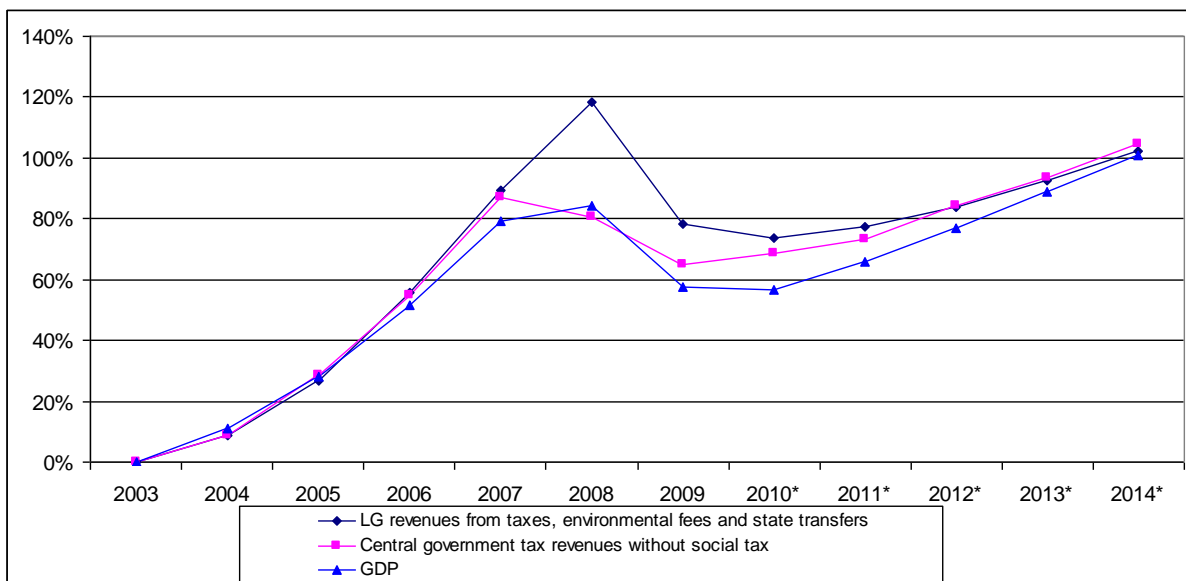
67. Although the members of the Congress monitoring delegation share the view that the decline in the income base of local authorities was large in terms of both amount and effect, this was only so in the case of 2009, and cannot be regarded as imposing a disproportionate burden compared to that borne by central government. According to the information relating to the year 2009 provided by the Minister for Regional Affairs, "the decrease of state budget revenue was 13% and the decrease in the local government revenue base was 13.7%".

68. Viewed over a longer period, local authorities' total budget rose sharply, as revealed by Figure 1.

69. Nonetheless, the serious effects of the economic depression have increased local authorities' financial vulnerability as they prepare to tackle the disadvantageous repercussions of the economic climate.

**Figure 1**

**GDP and local and central government income from 2003 to 2014**



## 2. Consultation procedure

70. The complaint made by the Estonian delegation also drew the Congress' attention to the fact that central government had not consulted the local authorities in the proper way prior to taking the aforementioned measures, as required by Article 9 Section 6 of the Charter. There was only "little consultation with local authorities, their proposals and past agreements were not taken into account".

71. The delegation is convinced that, in a period of economic depression with potentially serious effects on local authorities' financial situation, coordination between central government and local authorities' representatives has a crucial role to play.

72. It is a fundamental principle of the Charter that local authorities must be consulted, "in an appropriate manner" on the way in which redistributed resources are to be allocated to them. Although the requirement for consultation "in an appropriate manner" does not imply that local authorities' proposals must be accepted, associations of local authorities have to be involved in the decision-making process. In other words, local authorities' interests and recommendations must be considered carefully, and these authorities must be informed of the final decisions taken and of the reasons for those decisions.

73. Although the national associations of Estonian local authorities had been consulted before economic restrictions negatively affecting their budgets were introduced, at the time of the negotiations between Government representatives and the delegation of the Local Government Associations Co-operation Assembly on 11 February 2009, this did not meet the requirements of the Charter. The representatives of local government associations pointed out to the Government that they only had a little information, and this was contradictory, so they were not on an equal footing for the purposes of preparing a real compromise. Moreover, as the delegation has been informed, this meeting was held only a couple of days before the final decision was taken, when there was no real possibility of changing the planned measures. Mere reference to the urgent nature of the economic austerity programme is not a sufficient argument to justify the lack of genuine negotiations.

## 3. Special status of the capital city

74. The delegation which made the visit in Estonia in 2000 noted in the report that one of the issues on the agenda was to give a special legal status to the City of Tallinn. The representatives of the capital had told the members of the Congress delegation that they supported the preparation of a separate law on Tallinn's status recognizing the special role and significance of the metropolitan government. In the meantime, the Congress adopted in 2007 a recommendation on the status of capital cities which recommends the member states in particular to involve the municipal government of the capital city, which is in the process of being granted a special status, in the decision-making process, guaranteeing the possibility of prior consultation, according to Article 4.6 of the European Charter on Local Self-Government (as should be the case with every new legislation with an impact on the capital city) and to recognise the municipal government status of capitals in member states where this is not yet the case. Unfortunately, the current Congress delegation still notes that this issue remains unsolved and that any special status has been granted to Tallinn in the meantime. The delegation stresses that the recommendation of 2007<sup>10</sup> can provide some relevant elements to the national authorities to start this process of granting a special status to Tallinn.

## III. Conclusions and proposals

75. As the relevant information was summarised about the situation of local and regional democracy in Estonia and the conclusions were drawn about the specific controversial issues which have recently arisen, the Rapporteur would like to suggest that the Estonian authorities consider the proposals set out below.

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<sup>10</sup> Recommendation 219 (2007)

76. The members of the Congress delegation welcome certain changes and progress that have been made since the first monitoring report on Estonia in 2000. Some recommendations of the Congress<sup>11</sup> have been accepted and taken up, including the extension of the mandate of local authority councils from three to four years, and the encouragement of mergers between small local authorities, on a strictly voluntary basis.

77. While other recommendations have not been followed, alternative solutions have been found, with encouragement being given to local authority mergers rather than the transformation of administrative regions into self-governing regional authorities.

78. The first report suggested as well that “the legislature and the central government should consider giving special legal status for the City of Tallinn recognising the capital's importance in the country. In doing so, the current distribution of tasks and functions between Tallinn and the relevant county government could also be reviewed”. This recommendation still seems justified today, bearing in mind the special situation of the capital city: Tallinn accounts for about 28% of Estonia's population, and the capital provides more than 50% of Estonian GDP. Although parliament amended the Local Authority Council Election Act and the Local Government Organisation Act in 2008 and 2009 – amendments which also affected the internal organisation of the city's government (e.g. providing that the minimum size of the City Council of Tallinn must be 79 members, and prescribing that the electoral districts must coincide with the districts of the capital) – it has not created a special status for Tallinn. Consideration should still be given to providing the capital city with a special status recognising its unique character.

79. In accordance with the Charter's provision that “[p]art 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”, we recommend that a wide-ranging consultation process is started on financial reform of local authorities, with the aim of providing local authorities with a greater proportion of financial resources of their own, particularly through a greater capacity to raise revenue from local taxes, or alternatively of building into the present system stronger guarantees that local authorities will receive revenue from shared taxes (such as personal income tax) in a more transparent way. Increased financial autonomy could strengthen local authorities' economic position and reduce their vulnerability when a more restrictive economic policy is pursued by central government.

80. The delegation welcomes the Supreme Court decision, cited above, that legislation should be adopted under which the mandatory tasks and functions of local government are clearly defined, and creating a funding system which is fit for purpose and enables local authorities to fulfil the minimum local functions required. These are basic requirements for a transparent and effective local government finance system, which is also required by the Charter (see particularly Article 4 Section 1 and Article 9 Sections 1 and 2).

81. The Congress is strongly committed to the need for a genuine and effective system of consultation between central and local government. The coordination required in member states goes beyond a mere formal procedure without any role in shaping local government policy. Central authorities and the national associations of local authorities should make every effort to work together in this framework, and to negotiate with each other in due time and in a proper manner. Such coordination must involve at least the provision of any information of importance to the representatives of local authorities, who must be asked to give their opinions and have careful consideration given to their views and proposals. There are insufficient grounds for suspending the operation of this mechanism, or for denying use of the procedure for "pressing" economic or political reasons. Indeed, coordination is indicative of the partnership that exists between national and local authorities in all member states of the Council of Europe.

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<sup>11</sup> Recommendation 81 (2000)

**APPENDICES****Appendix 1****List of written documents examined**

## Laws and statutory regulations

- Constitution of the Republic of Estonia;
- Local Government Organisation Act of 1993;
- Local Taxes Act of 1994;
- Local Authority Council Election Act of 2002;
- Rural Municipality and City Budgets Act of 1993;
- Territory of Estonia Administrative Division Act of 1995.

## Other documents and information

- Report on Local Democracy in Estonia - CPL (7) 7 Part II, 2000;
- Negotiations between the Government Committee and the delegation from the Local Government Associations Co-operation Assembly. Minutes No. 1, 11 February 2009;
- Position of the expert group on problems raised by the Estonian delegation to the Congress, St Gallen, 29 September 2009;
- Granting culture, sports and youth work support to citizens' associations from rural municipality and city budgets. Report of the National Audit Office to the Riigikogu. Tallinn, 25 February 2010;
- Analysis of changes in the revenue and expenditure as well as financial situation of rural municipalities and cities in 2009. National Audit Office' report to parliament, Tallinn, 20 April 2010;
- Constitutional Judgement 3-4-1-8-09 of the Supreme Court of Estonia, 16 March 2010;
- Letter from Mr Edgar Savisaar, Mayor of Tallinn, to Mr Ian Micallef, 23 March 2009;
- Letter from Mrs Saima Kalev, head of the Estonian delegation to the Congress, to Mr Ian Micallef, CPL/BUR(16)7, 12 May 2009;
- Letter from Mr Siim-Valmar Kiisler, Minister for Regional Affairs, to Mr Ian Micallef, 12 October 2009.

## Appendix 2

### Programme of a monitoring visit of the Congress of Local and Regional Authorities in Estonia Tallinn, Haapsalu, Tartu (26-28 April 2010)

Mr. Jos WIENEN	Rapporteur on local democracy, member of the Institutional Committee of the Congress, Netherlands
Prof. Zoltán SZENTE	Member of the Group of Independent Experts on the European Charter on Local Self-Government of the Congress, Hungary

#### Monday, 26 April 2010 (Tallinn and Haapsalu)

- Meeting with the Estonian Congress delegation and meeting with the representatives of the Estonian Local Government associations (Association of Estonian Cities (AEC), Association of Rural Municipalities of Estonia (ARME))

Estonian Congress delegation: Mrs. Saima KALEV, Head of the Delegation  
Mr. Jüri LANDBERG  
Mr. Mihkel JUHKAMI

Association of Estonian Cities: Mr. Jüri VÕIGEMAST, Executive Director

Association of Municipalities of Estonia: Mr. Ott KASURI, Executive Director  
Mr. Märt MOLL, Financial Advisor  
Ms. Tiina ÜKSVÄRAV, Legal Advisor  
Dr. Toomas VÄLIMÄE, former member and head of the Estonian Congress delegation  
Mr. Kaimo KAARMANN-LIIVE, Secretary of the Estonian Congress delegation

- Meeting in the Parliament with: Mr. Väino LINDE, Head of the Constitutional Committee  
Mr. Taavi ROIVAS, Head of the Finance Committee  
Mr. Kalev KOTKAS, Head of the Rural Affairs Committee

- Meeting with Mr Edgar SAVISAAR, Mayor of Tallinn

- Meeting with representatives of the Haapsalu City Government and Kambja Rural Municipality  
Mr. Urmas Sukles, Mayor of Haapsalu  
Mr. Martin Schwindt, Finance Manager of Haapsalu City  
Mr. Ivar Tedrema, Mayor of Kambja Rural Municipality

#### Tuesday, 27 April 2010 (Tallinn and Tartu)

- Meeting with Mr. Siim Valmar KIISLER, Minister for Regional Affairs and Mr Triin TOOMPUU, Adviser for Foreign Relations

- Meeting with Mr. Jürgen LIGI, Minister of Finance  
Assisted by Mr. Sulev LIIVIK, Local Governments Financial Management Department, Ministry of Finance, and Mr. Andres KUNINGAS, EU and International Affairs Department, Ministry of Finance

- Meeting with Mr. Märt RASK, Chief Justice of the Estonian Supreme Court, and Ms. Mari-Liis LIPSTOK, Executive Assistant to the Chief Justice

#### Wednesday, 28 April 2010

Departure of the Congress delegation