Tallinn Estonia

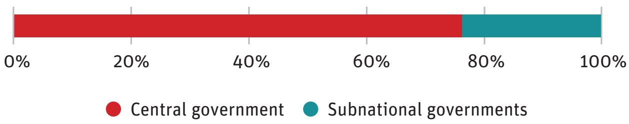
CITY:
0.4 mil. inhabitants

METROPOLITAN AREA
0.6 mil.
(+3.4% pop. change/5 years)

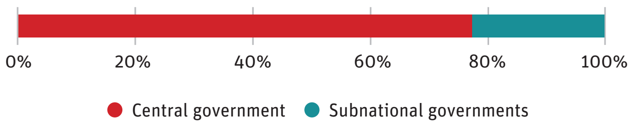
GDP: 109% of the average EU28 GDP
(+3.7% average annual change in GDP/5 years)

How local public finance systems work in Estonia

PUBLIC REVENUE



CAPITAL EXPENDITURE



Estonia has a **single tier of subnational government** (SNG). In 2018, it consisted of 79 municipalities; 15 of which were urban municipalities (linnad) and 64 were rural municipalities (vallad) - all municipalities have the same legal status.

The basic legal provisions concerning the financing of SNGs are enshrined in the Constitution. **At present, SNGs have very limited powers and means to increase their own revenue.** As a result of this limitation, they depend heavily on transfers and grants from the national government.

SNG's share in the total public investment is 24% (significantly lower than the OECD average of 57%). Most municipal investment is made in transportation infrastructure — specifically, municipalities invest in local roads, public transportation, tourism and business infrastructure (with a little less going to infrastructure for education, recreation and culture). In contrast, municipalities invest very little in social care, housing or general public services. Estonia draws from European structural and investment funds, which play a significant role at the municipal level, where they serve to finance projects such as schools, daycare centers, etc. **At the national level, the government plans to earmark 1.3% of the GDP for infrastructure investment from 2018–2020, 40% of which will go to the transportation sector.**

Estonian municipalities (especially in rural areas) do not have much opportunity to influence their revenue, which consists primarily of transfers from the central government. The share of transfers and grants in total SNG revenue is 85% (in 2016 this was significantly higher than the OECD average of 37%), while the share of taxes was just 3.5% (significantly less in 2016 than the average of OECD unitary countries at 45%) — which puts SNGs in Estonia last among the OECD countries with respect to the share of tax revenue.

Prior to the 2008 SNA reform, which Estonia adopted in 2014, revenue from shared taxes (such as personal income tax) was considered tax revenue; after the reform, this revenue is considered to be a transfer from the central government, which is the reason for the sharp drop in tax revenue after 2014. The fiscal autonomy of municipalities is very limited; only the richest municipalities (roughly 20%) have self-financing capacities. Even in the Capital City of Tallinn, 60% of the 2016 municipal budget consisted of a transfer based on the redistribution of personal income tax, 16% came from other state transfers, 11% from the sale of assets and services and 5% from own-source land tax revenue.

With respect to tax collection, Estonia is the most centralized OECD country; SNG tax revenue amounts to just 0.3% of the GDP and 1.5% of the total public tax revenue (while in OECD unitary countries it is 5% and 20%). Municipalities also have limited autonomy in introducing new taxes. The main component of local taxes is the land tax. Municipalities can (within the limits established by law) set the property tax rate; this specifically concerns a rate of 0.1–2.5% of the tax value of the property. The property tax in 2016 accounted for 84% of the municipal tax revenue and 2.9% of their total revenue. It amounted to 0.3% of the GDP (OECD 1.1%). Municipalities also have the ability to collect taxes on advertising (7% of SNG tax revenue), the use of water (7%) and use of public space (2%).

SNGs are heavily dependent on state transfers and grants, which constitute up to 85% of their total revenue. Most municipal grant revenues come from a share in personal income tax. Earmarked block grants make up the second-largest source of transfer revenue. These include transfers for education (especially for teacher salaries) and transfers for social benefits. Reforms are currently being considered that would reduce the share of these earmarked transfers calculated according to a formula and introduce a more effective system based on performance.

Transfers also include the **equalisation fund scheme, which ensures redistribution of revenue to poorest municipalities.** Equalisation transfers are determined each year as part of the state budget. They are based on a formula defined by population size, revenue for the past 3 years and anticipated expenditures.

SNGs also receive capital transfers, including EU funds, which finance roughly one-third of their total investments. Yet, capital transfers in 2016 accounted for just 3.2% of the total grants revenue to SNGs. In addition, municipalities that have successfully merged are also entitled to a specific grant – according to the territorial administration reform.

Other sources of revenue account for just 11% of total SNG revenue (OECD 15%) and include fees and revenue from economic activities. Property income (the rent and sale of assets) belongs entirely to municipalities and makes up 1% of their revenue (compared to an OECD average of 1.4%).

Source: http://www.oecd.org/cfe/regional-policy/Observatory-on- Subnational-Government-Finance-and-Investment.htm