Estonia’s economic freedom score is 75.2, making its economy the 14th freest in the 2011 Index. Its overall score is 0.5 point higher than last year as a result of significant improvements in monetary and labor freedom. Estonia is ranked 5th out of 43 countries in the Europe region, and its overall score is well above the regional and world averages.

Flexibility and openness have given Estonia’s small economy an impressive capacity to adjust to external shocks. The non-financial private sector reacted quickly to the challenging economic environment in 2009 with wage cuts and swift employment adjustments facilitated by a new labor law. Sound economic policies, grounded in a strong commitment to economic freedom, have ensured high levels of investment and entrepreneurial activity.

Although Estonia scores well in most of the 10 economic freedoms, government spending remains relatively high. Public finance management would benefit from longer-term budget balancing goals, clearer coordination between central and local governments, and better targeting of social benefits. The debt burden is quite low and has not undermined the country’s long-term economic competitiveness.

BACKGROUND: A model of stable multi-party democracy, Estonia has experienced seven peaceful changes of coalition or cabinet since regaining its independence in 1991. It became a member of NATO and the European Union in 2004 and aims to join the euro zone in 2011, although Europe’s economic difficulties could delay this until 2012 or 2013. Since the fall of the Soviet Union, it has led reform among the former Soviet-bloc nations and has transformed itself into one of the world’s most dynamic and modern economies. The 2005–2007 credit bubble ended two decades of strong growth, and the economy, strongly affected by the downturn in Finland, Sweden, and Germany, contracted significantly in 2009.
Business Freedom: 80.9  \[\text{no change}\]

Modern regulatory procedures are far more streamlined than those of many other countries in the region. A recent reform facilitates insolvent firms’ restructuring and makes overall bankruptcy procedures easier and less costly, but the pace of reform has slowed somewhat.

Trade Freedom: 87.6  \[\text{+ 0.1}\]

Estonia’s trade policy is the same as that of other members of the European Union. The common EU weighted average tariff rate was 1.2 percent in 2009. However, the EU has high or escalating tariffs for agricultural and manufacturing products, and its MFN tariff code is complex. Non-tariff barriers reflected in EU and Estonian policy include agricultural and manufacturing subsidies, quotas, import restrictions and bans for some goods and services, market access restrictions in some services sectors, non-transparent and restrictive regulations and standards, and inconsistent regulatory and customs administration among EU members. Ten points were deducted from Estonia’s trade freedom score to account for non-tariff barriers.

Fiscal Freedom: 80.7  \[\text{+ 0.5}\]

Estonia has moderate tax rates. The personal income tax rate is a flat 21 percent. The corporate tax is also 21 percent. Undistributed profits are not taxed. Other taxes include a value-added tax (VAT) and excise taxes. In the most recent year, overall tax revenue as a percentage of GDP was 32.3 percent.

Government Spending: 52.2  \[\text{– 10.0}\]

In the most recent year, total government expenditures, including consumption and transfer payments, rose to 39.9 percent of GDP. Estonia weathered the global financial crisis because of its accumulated fiscal reserves and low levels of public debt. General government debt is estimated at 5.7 percent of GDP. The fiscal deficit is around 3 percent of GDP. The private sector generates more than 80 percent of GDP.

Monetary Freedom: 78.7  \[\text{+ 7.6}\]

Inflation has been moderating, averaging 3.2 percent between 2007 and 2009. As a participant in the EU’s Common Agricultural Policy, the government subsidizes agricultural production, distorting the prices of agricultural products. It also subsidizes fuel and rent. Ten points were deducted from Estonia’s monetary freedom score to account for policies that distort domestic prices.

Investment Freedom: 90  \[\text{no change}\]

Although foreign and domestic investors have the same legal rights, the commercial community’s small size can result in regulatory favoritism. Foreigners may invest in all sectors. Licenses required for investment in banking, mining, gas and water supply, railroads and transport, energy, and communications are allocated in a non-discriminatory manner. The foreign investment code is transparent. Residents and non-residents may hold foreign exchange accounts, and payments, transfers, and most capital transactions are not subject to controls. Property may not be expropriated without full compensation.

Financial Freedom: 80  \[\text{no change}\]

Estonia’s modern financial sector is supported by transparent and efficient regulatory and supervisory frameworks. The banking sector is competitive and provides a wide range of financial services. Four banks still control over 90 percent of assets. The government has no financial stake in any local credit institution. Foreign financial institutions are welcome, and foreign firms dominate the insurance sector. Credit is allocated on market terms and is available to foreign investors. The small but active stock exchange is part of a network of Scandinavian and Baltic exchanges. The financial sector weathered the global financial turmoil relatively well because of sound supervision and support measures. Commercial banks have remained well capitalized, and there has been no extensive state intervention. Non-performing loans have been on the rise.

Property Rights: 80  \[\text{no change}\]

Estonia’s judiciary is insulated from government influence. Property rights and contracts are enforced, and the commercial code is applied consistently. The long and complicated property restitution process is almost complete, including in the area of non-residential real property. Estonian law is in compliance with EU directives protecting intellectual property rights. Estonia is ranked 29th out of 125 countries in the 2010 International Property Rights Index.

Freedom from Corruption: 66  \[\text{no change}\]

Corruption is perceived as present. Estonia ranks 27th out of 180 countries in Transparency International’s Corruption Perceptions Index for 2009. Estonia has laws, regulations, and penalties to combat corruption, and the corruption that does exist is generally not targeted at foreign investors.

Labor Freedom: 55.8  \[\text{+ 8.8}\]

Estonia has pursued measures to upgrade labor regulations and make the labor market more dynamic. Enhancing labor productivity has been a key area, and the recently enacted labor law aims to increase flexibility by reducing layoff costs.