Financing social protection

Estonia

Märt Masso
Merilen Laurimäe
EUROPEAN COMMISSION
Directorate-General for Employment, Social Affairs and Inclusion
Directorate C — Social Affairs
Unit C.2 — Modernisation of social protection systems
Contact: Giulia Pagliani
E-mail: Giulia.PAGLIANI@ec.europa.eu

European Commission
B-1049 Brussels
European Social Policy Network (ESPN)

ESPN Thematic Report on Financing social protection

Estonia

2019

Märt Masso, Merilen Laurimäe
The European Social Policy Network (ESPN) was established in July 2014 on the initiative of the European Commission to provide high-quality and timely independent information, advice, analysis and expertise on social policy issues in the European Union and neighbouring countries.

The ESPN brings together into a single network the work that used to be carried out by the European Network of Independent Experts on Social Inclusion, the Network for the Analytical Support on the Socio-Economic Impact of Social Protection Reforms (ASISP) and the MISSOC (Mutual Information Systems on Social Protection) secretariat.

The ESPN is managed by the Luxembourg Institute of Socio-Economic Research (LISER) and APPLICA, together with the European Social Observatory (OSE).

For more information on the ESPN, see:
http:ec.europa.eusocialmain.jsp?catId=1135&langId=en

**Europe Direct is a service to help you find answers to your questions about the European Union.**

**Freephone number (**):

00 800 6 7 8 9 10 11

(*) The information given is free, as are most calls (though some operators, phone boxes or hotels may charge you).

**LEGAL NOTICE**

This document has been prepared for the European Commission, however it reflects the views only of the authors, and the Commission cannot be held responsible for any use which may be made of the information contained therein.


© European Union, 2019
Reproduction is authorised provided the source is acknowledged

Contents

SUMMARY ........................................................................................................................................... 4

1 CURRENT LEVELS AND PAST CHANGES IN FINANCING SOCIAL PROTECTION ............... 5

2 CURRENT MIX AND PAST CHANGES IN THE SOURCES OF FINANCING SOCIAL PROTECTION .......................................................................................................................................... 7

2.1 Social tax .................................................................................................................................. 8

2.2 Old-age pension ....................................................................................................................... 9

2.3 Health....................................................................................................................................... 11

2.4 Unemployment ......................................................................................................................... 13

2.5 Benefits financed by general taxes or through structural aid from the European Union ........................................................................................................................................ 14

3 STRENGTHS AND WEAKNESSES OF THE EXISTING MIX OF FINANCING OPTIONS AND POTENTIAL FUTURE SOURCES OF FINANCING - NATIONAL DEBATE ON THE TOPIC .... 16

REFERENCES ...................................................................................................................................... 18
Summary

Estonia (EE) has had conservative government financial policy, including social protection financial policy, over recent decades. Also, the current government sector budget strategy proposes nominal surplus and structural balance during the coming years.

The social protection budget is relatively small, at 16.6% of GDP, compared to a number of other EU countries, including neighbouring Nordic countries (EU average 28.2%). Still, the growth of expenditure in real terms has been on average higher in Estonia – since 2005, it has increased by 4.9 percentage points. The increase could be explained by a co-occurrence of different factors, including the demand for more welfare and the focus of policy making, convergence with ‘social Europe’, recession and population ageing.

Around 80% of the financing of social protection in Estonia comes from social contributions that are paid by both employers and the persons protected. During the last decade, the general government contributions and other receipts have not changed significantly. This makes the Estonian social protection system more similar to a Bismarckian social insurance model. Neither the taxation of benefits, nor the tax allowances nor the country’s means-tested benefits have significant implications for the level of expenditure and receipts of social protection in Estonia.

The social contributions are social tax and unemployment insurance tax collected by the central public administration. The social tax is paid by employers and the self-employed, and it funds the pension insurance and the health insurance. The social tax rate is 33%, of which 13% is transferred into the Estonian Health Insurance Fund and 20% into the pension insurance schemes (the first and the second pillars). The unemployment contribution payment base is the same as the social tax base. The unemployment insurance contribution rate was 1.6% for employees and 0.8% for employers in 2018.

Aside from population ageing, the sustainability of the social protection system depends on changes in the employment level, type of employment and productivity. It has been suggested that, in order to keep the social protection system afloat in the long run, there is a need to consider changes in the tax system – and also some alternative sources of financing, including the introduction of private insurance.

The relatively high proportion of government revenue comes from proportional payroll and consumption taxes, while revenue from capital taxes is among the lowest in the European Union. During the coming decades, we could see Estonia gradually diversifying the revenue base away from the earmarked social payroll tax, and also making the tax system more diverse and progressive, which may also influence social protection expenditure.

Also, as consumption taxes tend to be regressive, with a proportionally bigger impact on lower-income than on higher-income households, the revenue from capital taxes in financing social protection could be increased. That would also influence expenditure – for instance, spending on minimum income support would decrease.

A considerable part of the financing of the social, labour and health sectors comes from EU aid. However, in many cases there is no clarity yet on how expenditure (e.g. work ability benefits) will be financed after 2021, when the current EU funds will run out.
1 Current levels and past changes in financing social protection

In Estonia, the tax system is largely a unified, national system consisting of social tax, unemployment insurance contributions, income tax, value added tax and excise taxes. The relatively high proportion of government revenue comes from proportional payroll and consumption taxes, while revenue from capital taxes is among the lowest in the European Union. Estonia has followed conservative government financial policy, including social protection financial policy, over recent decades. In 2017, the lowest ratio of government debt to GDP was recorded in Estonia (8.7%, compared to an EU-28 average of 81.6%). Also, the current government sector budget strategy proposes nominal surplus and structural balance during the coming years.

There are several classifications for welfare states in general, and for social protection systems in particular (e.g. Esping-Andersen, 2013. In most of the analyses based on these classifications, the Estonian social protection system is classified as a liberal welfare system, due to its relatively low level of redistribution and protection provided, and its reliance on social insurance schemes (Masso et al., 2018b).

Financing social protection is closely linked to the role of government in the economy. In 2015, the government tax revenue was 35% of GDP in Estonia – lower than the EU-28 average of 39.7% (Eurostat database, 2018). Due to the modest role played by the government in the economy, the social protection budget is also relatively small, compared to a number of other EU countries, including neighbouring Nordic countries. In 2016, the share of gross expenditure on social protection was 16.6% of total GDP, while the EU-28 average was 12 percentage points higher, at 28.2% (see Figure 1). The share of financing social protection has increased, and during the economic recession expenditure peaked, due both to a decrease in GDP, and increased expenditure on unemployment.

Figure 1: Gross expenditure on social protection


About 41% of total expenditure goes on old age (see Figure 2), 29.8% on health and sickness, and 28.7% on other branches, such as family (13%), disability (11.4%), unemployment (2.9%), social exclusion (0.6%), housing (0.4%) and survivors (0.3%). Over the years, there has been more continuity than change in expenditure on social protection by function; however, there have been increases in spending on disability (from 9.4% in 2005 to 11.4% in 2015) and unemployment (from 1.3% in 2005 to 4.2% in 2010) which were attributed to the economic recession.
Figure 2: Gross expenditure on social protection by function, % of total financing


Neither the taxation of benefits nor the country’s means-tested benefits have any significant implications on the level of expenditure and receipts of social protection in Estonia. As replacement income provided by the social protection benefits are taxed, net social protection expenditure was 0.3 percentage points lower than the gross figure in 2015 – a considerably smaller difference than in the EU on average (2.2 percentage points in 2015). The effective tax and social contribution rates on social protection expenditure are considerably lower in Estonia (2.1%) than in the EU-28 on average (7.8%).

Means testing is not used extensively in the Estonian social protection system to target benefits at those most in need. The share of expenditure on means-tested benefits has been less than 1% during most of the past decade. Also, tax allowances are not considerable, making up 0.2% of GDP.

---

1 The following income sources are non-taxable: all family benefits (except parental benefit), unemployment allowance, unemployment retraining benefit, subsistence benefit, annual refund for low-paid employees (in 2016), scholarships and grants, voluntary maintenance payments and dividends, on which firms pay only corporate income tax in Estonia.

2 In the Estonian social protection system, tax allowances do not play a major role. First, there is the basic allowance, which was €144 (per month) in 2011-2014, €154 in 2015, €170 in 2016 and €180 in 2017. Secondly, there is the pension allowance, which was €210 in 2014, €220 in 2015, €225 in 2016 and €236 in 2017 (per month). Thirdly, there is an additional allowance for families: prior to 2016, the amount per child (from 2009, from the second child onwards) was equal to the basic allowance, less the taxable income of the children; since 2016, the amount of the additional child allowance has been detached from the basic allowance and fixed at the level of the basic allowance in 2015 (i.e. the child allowance per child from the second child onwards was €154 per month in 2016-2018).

Contributions to the unemployment insurance fund and to the funded pension scheme, as well as alimony or maintenance payments, are fully deductible from taxable income.

The following expenses can be deducted from taxable income, but no more than 50% of taxable income in total or €1,920 (per year) in 2012-2015 and €1,200 in 2016-2018: housing loan interest payments, education expenses and donations. From 2017, there has been a further separate cap on housing loan interest payments (€300 per year, including in 2018).
2 Current mix and past changes in the sources of financing social protection

Social protection systems and schemes are classified into contributory and non-contributory social security, although in reality the systems usually combine both (Cichon et al. 2005). The Estonian social protection system gravitates toward a contributory system. Estonia is among those EU Member States where social contributions represent the largest component of receipts – in 2016, 78.9% of total financing came from social contributions, and about 20% from general government revenues (EU-28 average: 54.5% from social contributions and 40.4% from general government contributions), and the rate has been relatively stable throughout the years (see Figure 3 and Figure 4).

![Figure 3: Division of financing for social protection by main source, % of total financing](image)


Pension contributions to the third pillar (i.e. voluntary funded schemes) can be deducted from taxable income, up to 15% of taxable income, or €6,000 (per year). Since 2016, 20% of rental income from one residential property can be deducted from taxable income, as that is considered to reflect the owner’s costs related to renting.
The share of total social contributions in total receipts is high in Estonia. Social protection contributions (i.e. social tax and unemployment insurance tax) fund pensions, healthcare and unemployment insurance. Previous contributions determine the eligibility and amount of the contributory benefits (in particular, unemployment insurance benefits, maternity benefits, incapacity to work benefits, pensions).

2.1 Social tax

The social tax is a payroll tax paid by employers and the self-employed, and it funds the pension insurance and health insurance. The social tax rate is 33%, of which 13% is transferred into the Estonian Health Insurance Fund and 20% into pension insurance schemes (the first and the second pillars). The tax base is the gross wage for employers and business income for the self-employed. The social tax rate has not changed since its introduction in the 1990s.

There is a minimum monthly base for social tax calculation, set by the State Budget Act. The minimum obligation for social tax increased during the period 2005-2019, and in 2019 it stands at €165 (see Figure 5).
The minimum obligation for social tax depends on the minimum wage, but it does not depend on the employee’s working time (part-time or temporary work). There is no upper ceiling of social contributions, except for the self-employed. For certain inactive groups of people (e.g. parents on maternity leave, registered unemployed, military service, etc.) the state pays the social tax, based on the minimum social tax base in most cases. In addition, the state pays additional contributions to the funded pension scheme (second pillar) for people on parental benefits.

2.2 Old-age pension

The Estonian pension system consists of three main schemes: a state pension insurance (a pay-as-you-go system with a points scheme); a compulsory funded pension scheme (defined contribution scheme), optional for older cohorts; and a voluntary funded pension scheme (defined contribution scheme). The national pensions and pension supplements are financed from the general state budget, whereas the old-age and survivors’ pensions are predominantly financed from an earmarked social tax paid by employers and the self-employed at a rate of 16% or 20% of gross earnings (MISSOC, 2018). At the moment, the Estonian pension system is in deficit – and probably will continue to be until 2040-2050. The coverage of the state pension insurance system is practically universal.

If someone participates in the funded pension insurance scheme (the second pillar of the pension scheme), 4% of the social tax is shifted from the state pension insurance scheme to the private pension scheme and an additional 2% contribution from the gross wage is paid by the employee into the pension scheme second pillar. Employees may also contribute to the voluntary pension schemes (the third pillar), and those contributions can be deducted from the income tax base up to a certain limit.

There were some temporary changes to the funded pension contributions in 2009-2010 and 2014-2017. Between 1 June 2009 and 31 December 2010, government contributions to the funded scheme were suspended. Persons with up to 10 years until retirement (those born 1954 or later) could apply to resume individual contributions (2%) from 1 January 2010, in which case state contributions from the social tax (4%) were transferred. Other age groups could also continue to pay individual contributions (2%) from 1 January 2010, but no contributions from social tax were transferred (i.e. the scheme applied was 2+0%). For any other participant in the funded scheme (i.e. persons not opting for voluntary continuation of individual contributions), contributions to the funded scheme were gradually resumed from 2011, when a 1+2% scheme was applied, and from 2012 in the...
full amount of 2+4%. For 2014-2017, there was a compensation mechanism that will transfer additional social tax revenues to the funded scheme. From 15 September 2013, those people who had joined the second pillar had the option to increase their contributions. Approximately 16% (about 106,000 people) increased their contributions to 3% of their gross wage (from the usual 2%), and the share of social tax transferred to the funded scheme increases from 4% to 6% of the gross wage. The transfers to the funded scheme increased to 6% also for those 180,000 people who continued their contributions in 2010-2011 but did not choose to raise their contributions in 2014-2017 (Masso et al., 2017).

The statutory funded pension scheme law was amended following criticism that the regulation of the pay-out phase was too rigid. The principal mode of benefit payment from the statutory funded scheme is in the form of an annuity contract. Besides a fixed-amount annuity, from 2018 it has also been possible to choose an annuity contract with investment risk. Also, if the accumulated amount is under a certain (low) level, the person has one extra option – having a fixed-term pay-out, rather than a lifetime annuity.

In 2018, the Ministry of Finance submitted a draft law to reduce management fees by a third from their current level (then called the base management fee), but to add the opportunity to take a performance fee for good results (not in conservative funds). The performance fee can be claimed if the growth in the pension fund’s net asset value is higher than the growth in the social tax pension insurance part. Both fees are calculated cumulatively. Besides the management fees, the Ministry of Finance relaxed investment rules and allowed 100% to be invested in equities (previously, the maximum that could be invested in stocks and equity funds was 75%). The law came into force in January 2019.

Over the years, the total financing of old-age benefits has been above the EU average; funding has generally been stable, but it decreased from 43.6% in 2010 to 41.5% in 2016. The structure of financing has also been stable overall, but the share of social contributions decreased by 2 percentage points between 2008 and 2016 (Figure 6).

**Figure 6: Division of financing of old-age benefits by main source, % of total financing**

[Figure showing the division of financing by main source from 2008 to 2016]


---

3 [Explanatory note of the draft Investment Funds Act (available in Estonian only).](#)
Regarding the pension system, there are ongoing concerns about its financial sustainability. The situation facing Estonian pensioners relative to the working-age population is worse than the average in the other EU countries. The rate of retired persons at risk of poverty or social exclusion is considerably higher than the EU-28 average (47.4% versus 18.7% in 2017) (Eurostat, 2019).

Regarding the future sustainability and adequacy of pensions, the main challenge is the ageing population. In 2018, the regulations relating to compulsory and voluntary pension funds became more flexible and gained more opportunities (Ministry of Social Affairs, 2018):

1. There will be an automatic link between life expectancy and retirement age from 2027.
2. Flexible retiring: there will be an actuarially neutral flexible retirement age by 2021. People can choose a suitable time for retirement, take out part of their pension or stop claiming their pension.
3. By 2021, the calculation of the state old age pension will be improved and first pillar new entitlements tied to years worked– there will be 50% insurance part and 50% pensionable service part.
4. Cohorts born in 1970-1982 will have an opportunity to join the second pillar (up until 2010, those born before 1983 had the opportunity to join the second pillar, but about a quarter of them did not join).

The pressure on the Estonian pension system’s sustainability comes not from the high replacement rates of pensions, but from high dependency rates. The old-age dependency ratio for Estonia is projected to rise by 29.1 percentage points – from 31.5% in 2016 to 60.6% in 2056, when it will be above the EU average (56.6% in 2056). Therefore, higher replacement rates, lower poverty among pensioners and consequently financial sustainability could be achieved through a combination of different approaches: increasing the effective retirement age, increasing voluntary savings, or using current expenditures more efficiently in targeting poverty (Piirits and Masso, 2017).

### 2.3 Health

As specified above, health insurance (covering sickness benefit, healthcare, long-term care, maternity) is funded from social tax. Insured persons are residents for whom the social tax is paid by their employer, by the government or by themselves (if they are self-employed), as well as equivalent persons under the Health Insurance Act for whom social tax is not paid. A few services are directly purchased from the state budget or paid for by household out-of-pocket (OOP) payments.

The ESSPROS statistics indicate that over the past decade, general government revenues in financing healthcare expenditure and sickness benefits have increased (see Figure 7).
The structure of Estonian healthcare financing has been relatively stable during 2005-2017 (see Table 1). About two thirds of healthcare financing comes from earmarked social tax via the Estonian Health Insurance Fund (EHIF) (64%). Central government’s share is about 8–10%, and local government’s share is about 1.5%. In 2017, about 24% of health expenditure came from household OOP (National Institute for Health Development, 2019).

Table 1: Sources of healthcare financing in Estonia, by institution (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector</td>
<td>74.8</td>
<td>75.7</td>
<td>75.9</td>
<td>77.0</td>
<td>77.9</td>
<td>76.3</td>
<td>76.9</td>
<td>76.7</td>
<td>75.6</td>
<td>75.7</td>
<td>75.6</td>
<td>75.7</td>
<td>74.8</td>
</tr>
<tr>
<td>Central government</td>
<td>9.0</td>
<td>9.6</td>
<td>9.3</td>
<td>9.4</td>
<td>9.1</td>
<td>9.6</td>
<td>9.6</td>
<td>9.5</td>
<td>9.6</td>
<td>8.9</td>
<td>9.2</td>
<td>9.3</td>
<td>9.1</td>
</tr>
<tr>
<td>Local government</td>
<td>0.9</td>
<td>1.6</td>
<td>1.5</td>
<td>1.5</td>
<td>1.6</td>
<td>1.3</td>
<td>1.5</td>
<td>1.3</td>
<td>1.4</td>
<td>1.4</td>
<td>1.6</td>
<td>1.3</td>
<td>1.2</td>
</tr>
<tr>
<td>Health Insurance Fund</td>
<td>64.8</td>
<td>64.5</td>
<td>65.1</td>
<td>66.1</td>
<td>67.2</td>
<td>65.4</td>
<td>65.7</td>
<td>65.8</td>
<td>64.7</td>
<td>65.4</td>
<td>64.8</td>
<td>65</td>
<td>64.4</td>
</tr>
<tr>
<td>Private sector</td>
<td>25.2</td>
<td>24.3</td>
<td>24.1</td>
<td>23.0</td>
<td>22.1</td>
<td>23.7</td>
<td>23.3</td>
<td>23.3</td>
<td>24.4</td>
<td>24.3</td>
<td>24.4</td>
<td>24.3</td>
<td>25.3</td>
</tr>
<tr>
<td>Private insurance</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Households</td>
<td>22.6</td>
<td>23.2</td>
<td>22.7</td>
<td>20.7</td>
<td>20.3</td>
<td>21.9</td>
<td>21.6</td>
<td>21.5</td>
<td>22.6</td>
<td>22.6</td>
<td>22.8</td>
<td>22.7</td>
<td>23.6</td>
</tr>
<tr>
<td>Non-profit sector</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Private enterprises</td>
<td>2.2</td>
<td>0.8</td>
<td>1.1</td>
<td>2.0</td>
<td>1.5</td>
<td>1.5</td>
<td>1.4</td>
<td>1.5</td>
<td>1.5</td>
<td>1.4</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Foreign sector</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

The sustainability of the health insurance system and the social protection system in general has been debated in the government and public sphere. Although the Health Insurance Fund’s revenue increased during the first half of 2016, the operating costs grew quicker than projected. The budget deficit is expected to increase in the long term, due to demographic ageing. The deficit has triggered a debate to find a solution to the long-term sustainability of healthcare funding. Parliament has approved extension of the revenue base of healthcare. The Estonian Health Insurance Fund’s reserves will run out within the next 10 years, but the maximum amount that can be used each year will be exceeded within the next five years. Regarding financing, the issue has its roots in the high levels of solidarity within the system, whereby roughly half of all the people do not directly contribute to the system. Lack of funding results in long waiting times and unmet need for care. The main reason for insufficient funding is that contributions to the system are related to employment, whereas non-contributing individuals (e.g. children, unemployed people) make up more than half of the number of insured people. This is a long-standing threat to the financial sustainability of the health system, as the narrow revenue base is mostly related to wages, at the same time as the population is ageing.

Recently, some steps have been taken to reform the financing. In April 2017, the government introduced health insurance contributions made on behalf of non-working pensioners. Contributions were set at 7% of the state pension in 2018, and will gradually increase to 13% in 2022. By this decision, Estonia has diversified the revenue base away from the earmarked social payroll tax. From 2018, the government pays a monthly allocation per pensioner not in employment into the EHIF budget. In 2017, it also proposed to transfer some healthcare costs (like the ambulance service) from the state budget to the health insurance system. The increasing transfers and contributions are making the health insurance system more sustainable, but not entirely.

### 2.4 Unemployment

The Estonian unemployment protection system includes unemployment insurance and an unemployment allowance scheme. Unemployment insurance contributions form a compulsory insurance scheme that covers an employee in case of unemployment, collective closing or insolvency of the employer, and an employer in case of collective cancellation of employment contracts (unemployment insurance benefit). Unemployment insurance contributions are paid by employees and employers. The unemployment contribution payment base is the same as the social tax base. Generally, the employee’s share is withheld from the gross wage, and the employer pays the contribution in addition to social tax. An employer’s obligation to calculate and withhold the unemployment insurance premiums for an insured person terminates on the last day of the month in which the insured person attains pensionable age or is granted an early-retirement pension; however, the employer is obliged to continue the unemployment insurance premiums payable by employers. The self-employed and members of management or controlling bodies of legal persons are not applicable for insurance and cannot make contributions.

The unemployment insurance contribution rate in 2018 was 1.6% for employees and 0.8% for employers, which was lower than it was between 2009 and 2014 (see Table 2). The increase in the contributions rate also reflects an increase in gross expenditure during the economic recession.

| Table 2: Unemployment insurance contribution rates, 2005-2020 |
|---------------|-----------------|-----------------|----------------|-----------------|-----------------|-----------------|-----------------|
| Employers     | 0.5%            | 0.3%            | 1%              | 1.4%            | 1%              | 0.8%            | 0.8%            |
| Employees     | 1%              | 0.6%            | 2%              | 2.8%            | 2%              | 1.6%            | 1.6%            |

Source: Masso et al. (2017).
In addition to the unemployment insurance that is financed via unemployment insurance contributions, there is an unemployment allowance that is financed from the state budget, and some services financed by the EU structural funds.

In 2015, gross expenditure on unemployment protection was 2.9% of GDP (see Figure 8). The share rose to 4.2% during the recession, but has since decreased. In 2015, 71.8% of unemployment protection costs were financed from social contributions and 28.2% from government contributions. Over the years, the financing from social contributions has increased considerably – about 12 percentage points between 2008 and 2016.

**Figure 8: Financing unemployment protection**

![Figure 8: Financing unemployment protection](source)


The unemployment insurance system has been in surplus during recent years. Estonian Unemployment Insurance Fund reserves have grown rapidly over the past couple of years, and some of the activities from the pension system and from social care have been transferred to unemployment insurance (e.g. work ability allowance) or else their transfer is up for discussion (e.g. sickness benefit).

### 2.5 Benefits financed by general taxes or through structural aid from the European Union

Only around 20% of the financing of social protection in Estonia relies on general government contributions and other receipts.

In 2014-2016, government channelled €645 million into developing the social, labour and health sectors. However, most of that (78%) came from the EU structural funds aid – €504 million. National co-financing amounts to €31.7 million, and contributions from beneficiaries to €109 million. European Union aid is used mainly for three measures: first, welfare services that support childcare and disabled children and participation in the labour market; second, implementation of work ability reform and the extension of labour market services to new target groups; third, developing health and welfare infrastructure (National Audit Office, 2017a).

In a number of cases, the contingency plan for financing the costs has been discussed. In 2016-2017, the work ability reform gradually entered into force and replaced work-incapacity pensions with work ability allowance.4 The work-incapacity pensions were financed by social tax, together with individual lifetime contributions to the pension

scheme. As of 1 January 2017, working ability will solely be assessed and allowances paid by the Unemployment Insurance Fund. In February 2017, the National Audit Office (2017b) reckoned that the state was only partly ready for implementation of the new work ability support system. Most importantly, the Audit Office pointed out that it is still unclear how the new system will be financed from 2021, when the current EU funds run out; the number of people who have lost their work ability and the capability of local governments to provide services should be considered when deciding on funding.
3 Strengths and weaknesses of the existing mix of financing options and potential future sources of financing - national debate on the topic

A relatively high proportion of government revenue comes from payroll and consumption taxes, while revenue from capital taxes is among the lowest in the European Union. Financing of social protection in Estonia relies mostly on social contributions. It is thus reasonable to expect that if we see an increase in social protection financing as a percentage of GPD in the coming decades, we will also see at least some steps away from a funding system based on social contributions. Also, as consumption taxes tend to be regressive – impacting lower-income households proportionately more than higher-income households – the revenue from capital taxes in financing social protection could also increase; this may also influence costs – for instance, minimum income support costs could decrease.

High taxation of employment has also motivated discussion of work incentives. Recently, there has been discussion that the minimum obligation for social tax might affect the supply of and companies motivation to offer low-paid part-time jobs, as the minimum obligation for social tax does not depend on working time (part-time or full-time). This makes it more expensive to hire a part-time worker (Ministry of Social Affairs, 2016). Therefore, there has been discussion of whether to change the conditions and extend the tax incentives for some affected groups, for whom part-time work may be necessary (e.g. parents of children up to 7 years of age or persons not in education, employment or training (NEET)). In the short term, this may reduce the tax revenue from social tax; however, in the longer term, if employment increases, so could revenue.

Financing and coverage of social protection in Estonia is not completely neutral to type of employment. Currently, the self-employed are not covered by unemployment insurance, and they do not pay unemployment insurance contributions. The Ministry of Social Affairs has commissioned a study to analyse how to improve the unemployment insurance system. The main problem of the Estonian system is insufficient social protection – the rates of the benefits are low, and a rather small share of the unemployed receive insurance benefits. According to the scenario analysis, the self-employed should also pay unemployment insurance contributions and receive unemployment insurance benefits. Presumably, this will somewhat increase the cost-benefit structure of the unemployment protection scheme.

Also, there has been discussion on increasing the role of compulsory private insurance in financing social protection. In September 2018, the Ministry of Social Affairs proposed developing a government-regulated private occupational accident insurance scheme in Estonia. Currently, the main costs of work accidents are covered by the Health Insurance Fund (for sickness benefit and medical expenses) and the Unemployment Insurance Fund (for work ability allowances and work rehabilitation). According to the proposal, the costs would be borne by the employer. The government-regulated private occupational accident insurance system would be compulsory, and employers would have to insure employees against work accidents. The employers’ overall employment tax burden would not increase, as the social tax or unemployment insurance premium rate would be reduced. As a result, although the compulsory social protection contributions burden will remain the same on average, the earmarked government tax would be replaced by compulsory contributions to private insurers.

According to the 2019 state budget, at the end of 2017 the liquid assets of the Estonian Unemployment Insurance Fund (Töötukassa) and the Estonian Health Insurance Fund (Haigekassa) totalled €898 million, while the reserves of social insurance funds are predicted to increase to €999 million by the end of 2019, reaching 3.7% of GDP. During the coming decades, the sustainability of the social protection system will depend on several factors, such as changes in employment level, employment type and productivity. Technological change and changes in the population structure can impact the ways in which people work and the overall number of the employed, on which social protection income
and expenditure depend (Masso et al., 2018b). According to statistics, the old-age dependency ratio in Estonia is projected to increase from 31.5% in 2016 (EU-28: 32.0%) to 60.6% in 2056 (EU-28: 56.6%). The share of the working-age population (64.9% of the total population in 2016) is projected to drop by 10.2 percentage points by 2056 (to 54.7%) (ESPN Country profile). The issue of sustainability has been mostly discussed in the context of pension and the healthcare system. It has been suggested that, in order to keep the social protection system afloat in the long run, there is a need to consider changes in the tax system and also some alternative sources of financing – e.g. an increase in tax rates, a change in the tax structure, the introduction of negative income tax, individual saving accounts (Masso et al., 2018b).

Considerable part of the financing of the social, labour and health sectors comes from EU aid. However, the financing of social protection might be placed in jeopardy if the EU aid decreases in the next period. According to estimates, EU aid might decrease in the next period (starting in 2021) by 40% (National Audit Office, 2017a). In addition, in many cases there is no clarity yet about how the benefits and services (e.g. work ability allowance) will be financed in the future (National Audit Office, 2017b).

---

5 Old-age dependency ratio – population aged 65 and over as a percentage of the population aged 20-64.
References


Eurostat, People at risk of poverty or social exclusion, [ilc_peps02].


National Institute for Health Development (2019). Health Statistics and Health Research Database; Table KK05: Indicators of current health care expenditure (http://pxweb.tai.ee/pxweb2015/pxweb/et/04THressursid/04THressursid__10THKogukulud/KK05.px/table/tableViewLayout2/?rxid=72451516-93af-43aa-9e47-705782ecc75c)


Töövõimetoetuse seadus. Riigi Teataja [Work Ability Allowance Act](https://www.riigiteataja.ee/akt/130122015103)
Getting in touch with the EU

In person

All over the European Union there are hundreds of Europe Direct Information Centres. You can find the address of the centre nearest you at: http://europa.eu/contact

On the phone or by e-mail

Europe Direct is a service that answers your questions about the European Union. You can contact this service
– by freephone: 00 800 6 7 8 9 10 11 (certain operators may charge for these calls),
– at the following standard number: +32 22999696 or
– by electronic mail via: http://europa.eu/contact

Finding information about the EU

Online

Information about the European Union in all the official languages of the EU is available on the Europa website at: http://europa.eu

EU Publications

You can download or order free and priced EU publications from EU Bookshop at: http://bookshop.europa.eu. Multiple copies of free publications may be obtained by contacting Europe Direct or your local information centre (see http://europa.eu/contact)

EU law and related documents

For access to legal information from the EU, including all EU law since 1951 in all the official language versions, go to EUR-Lex at: http://eur-lex.europa.eu

Open data from the EU

The EU Open Data Portal (http://data.europa.eu/euodp/en/data) provides access to datasets from the EU. Data can be downloaded and reused for free, both for commercial and non-commercial purposes.