Reforms of Social Insurance Governance in a Quasi-Bismarckian Welfare State: How Estonia Moved from Tripartism to Direct State Management

Toots, Anu

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Anu Toots*

Abstract

Continental welfare regimes in Western Europe have in recent decades gone through paradigmatic reforms that significantly altered the initial Bismarckian principles of social insurance governance. Existing research overwhelmingly concludes that social partners have relinquished their power to governments that inter alia facilitated the expansion of non-contributory social security instruments. This article asks to what extent this reform trajectory can be found in quasi-Bismarkian welfare states that lack vital social dialogue and favour a market-oriented approach to social security. Tracing the process of social insurance governance reforms in Estonia 2009–2019, we test the assumption that central government is actively intervening in the governance of social insurance similarly to the recent developments in typical Bismarckian countries. The main empirical finding is that using the weakness of labour market partners and the absence of veto points enables governments to undermine the principles of social insurance established in the early 1990s and move to direct state management of the social system (étatism). Yet, the move towards direct state management has occurred in insurance systems to varying degrees, and only in unemployment insurance can one classify episodes as 'critical junctures' during which actors' choices trigger a path-dependent process.

Keywords: Bismarckian welfare regime, social insurance, critical juncture, fiscal orthodoxy, étatisation, Estonia

Introduction

Population ageing, high sovereign debt and the persistence of poverty have been challenging the sustainability of European welfare states over the last twenty to thirty years. Political responses to these problems have attracted extensive research on national reforms, in particular in Bismarckian welfare countries (Seeleib-Kaiser, 2016; Häusermann, 2010; Palier, 2010) but also across the entire European Union (Beramendi, Häusermann, Kitshelt & Kriesi, 2015; Manow, Palier & Schwander, 2018; Taylor-Gooby, Leruth & Chung, 2017). Most of the existing literature on Central and Eastern European welfare states (CEEWS), however, still engages with regime typologies and social outcomes (Bohle & Greskovits, 2012; Saxonberg, 2013; Kuitto, 2016), whereas the latest institutional changes have remained understudied.

This situation has several shortcomings. First, while analysing welfare state outcomes is important, powerful policy mechanisms remain concealed. Second, CEEWS tend to be studied as still lacking a firm institutional structure, which seems to be unjustified thirty years on from the collapse of Soviet totalitarianism and after seventeen years of EU membership. Third, despite numerous attempts to accommodate CEEWS into Esping-Andersen's (1990) welfare states typology, they are regarded as separate entities labelled post-communist regimes (see O'Reilly, Leschke, Ortlieb, Seeleib-Kaiser & Villa, 2019). I argue the problems facing welfare states around Europe today are increasingly universal and less dependent on recent national political histories. Therefore, juxtaposing the latest social reforms in CEEWS with similar efforts in Western Europe can contribute to a better understanding of the main trajectories of welfare state development.

* E-mail: anu.toots@tlu.ee

This article seeks to fill gaps in the literature by studying social insurance governance reforms in Estonia 2009–2019. For the purpose of this article, governance is narrowed down to financial decisions and funding arrangements because these decisions are important aspects of welfare state governance. Some well-established scholars of the welfare state (Palier, 2010; Clegg, 2018) use 'governance' as a synonym for 'management', which is similar to the approach taken in this article. The study focuses on institutionally embedded reform processes instead of their social effects, and therefore qualifies the Estonian welfare regime as quasi-Bismarckian. A quasi-Bismarckian regime bears the core institutional features of the Bismarckian model, such as heavy reliance on employer and employee contributions in financing the welfare state, social insurance funds that are separated from the state budget, and the shared management of the funds with social partners (Clegg, 2018). At the same time, a constellation of power and power balance between the main political actors in quasi-Bismarckian countries can diverge from well institutionalised social dialogue (tripartism) and fragmented policymaking environment which are representative of the ideal - typical Bismarckian welfare model. In Estonia, social insurance administered by semi-autonomous funds (*Kassad*) forms part and parcel of the welfare state. At the same time, tripartism is deceptive and governments enjoy a policymaking environment with few veto points. The aim of the article is to show how in the 2010s Estonia made use of weak non-parliamentary actors and the lack of veto points in the political system to undermine the principles of social insurance established in the early 1990s and moved to direct state management of the social system (étatism). I argue that this trajectory from tripartism to étatisation visible in Western Bismarckian regimes (Palier, 2010) is also typical for quasi-Bismarckian Estonia.

Until now, Estonia has been studied in the welfare state literature as belonging with Latvia and Lithuania to a coherent Baltic trio (see Bohle & Greskovits, 2012; Kuitto, 2016). At the same time, cross-country diversity in the institutional design of welfare states is growing (Toots & Lauri, 2021; Palier, Rovny & Rovny, 2018; Aidukaite, 2019), which justifies in-depth country analyses. A single-country analysis can be invaluable in testing theoretical arguments about institutional adaptation using detailed empirics.

The article is structured as follows. The first section provides theoretical insights into recent reform trajectories in Western European Bismarckian regimes. Then, the methodological approach is explained, and the use of the process tracing method validated. The third section contextualises the empirical study by explaining the genesis of today's Estonian welfare state. Next, the analysis section tracks the main changes in the financing and governance of social insurance in the 2010s. The conclusion reviews the main findings and interprets them in light of the methodological and theoretical insights.

Theoretical insights: tripartism, stability and change in Western Bismarckian countries

A decade ago, Palier (2010) published a seminal book on the politics of welfare reform in Continental Europe and since then institutionalist-theoretical scholars claim that mature Continental European welfare states are saying farewell to Bismarck. Social policy reforms in France and Germany in the 1990s and 2000s have paradigmatically restructured the existing welfare model, which "no longer warrants labelling as a conservative welfare state" (Seeleib-Kaiser, 2016, p. 235). Marketisation, cuts in benefits, sacrificing the social protection of labour market insiders, changing the financing mechanisms towards less insurance contributions and more taxes, and more active state intervention in the governance of social insurance are typically seen as factors questioning the preservation of the Bismarckian tripartite model. Yet, the retrenchment of social insurance programmes in France or Germany has been accompanied by a clarification of responsibility between the state and social partners. While social partners lost their former influential position in fund boards, the burden of labour force taxation was eased and the share of non-contributory tax transfers to the social funds increased (Palier & Martin, 2007). This quid pro quo approach supports critical claims that the German welfare model, and social insurance as its core, have remained resilient and the accompanying social insurance revenues from state subsidies has long been a tradition (Blank, 2019). Despite some disagreement about regime change, scholars tend to agree that governments play in today's social insurance systems a more powerful role than traditionally.

There is no similar literature on developments in quasi-Bismarckian welfare systems in post-communist Europe. In general, one can assume that quasi-Bismarckian regimes in the Baltics are more agile in turning towards direct state management (i.e. étatisation) due to macro-economic and institutional factors. After having restored their independence, Estonia, Latvia and Lithuania conducted radical marketisation reforms, replacing the old industrial economy with a rapidly growing service sector. The modernisation of the economy had a substantial effect on the class structure of post-Soviet societies. The former massive working class lost its political voice, and a new middle class of highly skilled professionals in the public sector and tertiary economy emerged. This new middle class become an enthusiastic supporter of all kinds of market-oriented reforms, including those in social policy (Toots & Lauri, 2022). Trade unions, the key agent in protecting workers' interests in Western Europe, were revived in Eastern Europe in a different role and capacity. The social dialogue was discredited by the communist past and large unified enterprises were replaced by a plethora of small firms and markets opened up to international trade. As Ost (2009) claims, however, the communist legacies only partly explain the weakness of trade unions in the CEE. According to him, it is the pro-market orientation and immersion in the global economy which made trade union leaders more elitist and oriented towards agreeing with the government policies aimed at weakening them. Employers in the CEE similarly see trade unions as associated with the previous industrial era and since there are no longer any common working class interests in the globalised economy, unions become unnecessary (Kall, 2016).

The classical Bismarckian welfare model presumes decentralised government, multiple veto points and strong non-parliamentary players (Clegg, 2018; Ebbinghaus, 2010). Besides weak labour market partners, government-related prerequisites were also not fully met in most emerging CEE democracies. Estonia too has a unicameral parliamentary system with few veto points. Although the principle of checks and balances is written into the Constitution, the controlling institutions such as the National Audit Office (NAO) or Chancellor of Justice (CoJ)[1] can voice their protest about government activities without having the veto power. All this makes CEE governments that typically (as is the case in Estonia) control the parliamentary majority powerful actors (Bergman, Ilonszki & Müller, 2019) and opens the political space for étatisation.

But why might the political elites want direct control of social budgets, especially in the context of austerity? Two context-specific explanations can be suggested here. First, CEEWS started social policy reforms from the very low baseline level. Therefore, further retrenchment was not on the agenda until the recession of 2009, and the need for blame shifting did not exist. Second, in CEEWS generally, and in Baltic States in particular, building the welfare state was closely linked to a return to the discourse of the 'Western world'. It was overwhelmingly perceived that joining liberal democracies was necessary as quickly as possible and for this reason central state management works best.

This interrelatedness of domestic and international developments brings us to the broader question of the role of external factors. Because the trend towards the étatisation of the corporatist welfare states coincided with both economic and euro crises, it is often asked – whether external shocks simply triggered immanently maturing developments, or served as a true cause of change? Some accounts of historic institutionalism tend to see exogenous shocks as important 'windows of opportunity' or 'critical junctures' for path change (Cerami & Vanhuysse, 2009). In contrast, others (Mahoney & Thelen, 2010; Vis, van Kersbergen & Hylands, 2011; van Hooren, Kaash & Starke, 2014) argue that fundamental change in the aftermath of an exogenous shock is the exception rather than the rule and the crisis-rhetoric is used simply to implement previously inconceivable reforms. A closer look at the relevant welfare literature provides support for the latter position. Palier

1 NAO an independent state institution with responsibility for economic control. CoJ is an independent official supervising the accordance with the Constitution and legislation of the legal acts issued by the state legislature and executive, as well as by local government bodies.

(2000) shows how social partners became increasingly seen as uninterested in fighting for fiscal prudence, and therefore they already started to lose their former central position to the state actors in the late 1990s. When Eurozone criteria were posed by the EU Commission and ECB on national budgets in 2009 it further triggered the étatisation of the Bismarckian welfare model (Huber & Stephens, 2015; Hassenteufel & Palier, 2014). Germany, for example, abandoned the tradition that social insurance contributions should be shared equally by employers and employees, and made attempts to consolidate federal finances (Blank, 2019).

In summary, research provides solid evidence of the substantial transformation of Western Bismarckian welfare regimes towards increasing direct state management over social insurance systems. The next sections will clarify to what extent similar developments can be found in CEEWS, more precisely – in Estonia.

Methodology: application of institutionalist theory in studying welfare governance change

The analysis relies on institutionalist theory and process tracing, which are commonly used to study transformation and change. Previously, the logic of transformation in CEEWS has been explained using macro historic-institutionalist accounts related to the definition of the welfare regime type of countries under investigation (Cerami & Vanhuysse, 2009; Kuitto, 2016). Although macro-analyses are good for their own subject matter, they tend to neglect that institutions often emerge at various times and evolve at different speeds for distinct reasons. Therefore, welfare regime transformation should be conceptualised not as a wholesale move, but rather "as a punctuated, one-institution-at-a-time process, in which the institutional building blocks of it change asynchronously" (Capoccia & Ziblatt, 2010, p. 940). A moment "that constitutes a critical juncture with respect to one institution may not constitute a critical juncture with respect to another" (Capoccia & Kelemen, 2007, p. 349). Even though welfare governance institutions are interconnected, analytically it is important to keep them separate and to identify the key episodes for each unit of analysis.

In line with neoinstitutionalist theory, 'institutions' include not merely organisations and bodies, but also rules and regulations. Yet, the latter are constrained by institutional settings. The units of analysis in the current study are legislative efforts (implemented and not implemented) in governing two social insurance programmes – health insurance (including sickness benefits) and unemployment insurance. These programmes form the institutional core of the Bismarckian welfare model. Pension insurance has less regime-specific features, and therefore is of secondary interest here. Differently from many Western European countries, Estonia does not have a separate incapacity for work insurance and these benefits are paid out of the overall pool of social insurance contributions. Family benefits are financed out of general taxes.

When studying change in an institutionalist-theoretical framework, two issues need to be clarified. First, the period under scrutiny. Second, the method of identifying how certain decisions emerged from all the available options?

Historical institutionalism uses long time spans in order to discover path dependency. This is the approach taken by Cerami and Vanhuysse (2009), who found that the effects of the histories of CEEWS have multiple layers including occupational corporatist welfare traditions from the pre-communist period. Pierson (2001), by contrast, argues that in transition countries, a short-run path dependency may manifest itself and the initial reforms of post-communist transition may be more important in understanding the later reform trajectories than the deep historical layers. Relying on Pierson's (2001) argument, the current study focuses on a relatively short period – 2009 to 2019 – but relies on the policy choices of the 1990s to explain the changes in that decade. From the theoretical point of view, the concept of critical juncture and the definition of its timespan are relevant here. Capoccia and Kelemen (2007, p. 343) characterise critical junctures as a situation in which "the structural (i.e., economic, cultural, ideological, organisational) influences on political action are significantly relaxed that expands the range of plausible choices available to political actors". Such 'relaxed' periods are typically short but allow political actors to make choices that trigger durable path-dependent processes. In this definition, Mahoney and Thelen (2010) likewise emphasise the importance of agency and decisions by influential actors in critical junctures. The changes implemented gradually over several decades may also lead to substantial policy change (Pierson, 2001), but actors and structural influences play a less prominent role in those trajectories. Since this study is interested in policy change framed by the post-recession period (2009–2019) and Estonia's accession to the Eurozone (2011), the focus on critical juncture seems a more suitable choice than looking at gradual change.

As path changing policy decisions occur under conditions of uncertainty and relaxed institutional constraints, the methods adopted should reconstruct in a systematic way the decision-making process, identify which decisions were most influential and what options were available and viable to the actors. Process tracing and theory-guided narratives are apt methods for this kind of task. Various policy documents such as party platforms, government coalition agreements, reform plans, as well as parliamentary records, and primary and secondary legal acts are data sources worth considering. Yet, official available documents typically reflect those decisions that were put into practice and there is very little information about alternative choices that were 'on the table' during the critical junctures. Those choices that were not taken, 'the near misses', are important because ignoring them would introduce a selection bias (Capoccia & Ziblatt, 2010). The current study employs two methods to address this problem. First, all possible empirical data are gathered to trace the variety of existing policy options (see Appendix 1). Second, the principle of theoretical consistency is used as counterfactual. This principle looks at choices that were available and according to theory should have been adopted but in reality, were not (Capoccia & Kelemen, 2007). Besides providing methodological rigour to the empirical analysis, this also allows us to juxtapose changes in the governance of social insurance in CEEWS with those in Western Bismarckian countries.

Background: The making of the Estonian welfare state, 1991–2004

At about the same time as Esping-Andersen (1990) published his seminal work on 'three worlds of welfare', the Baltic States started to build their model of welfare capitalism. Because the economic and social situation was extremely unstable in the first half of the 1990s, policy decisions related to welfare institutions were somewhat hectic and *ad hoc* (Kalmus, Lauristin, Opermann & Vihalemm, 2020). Overall, the choices made on the governance of welfare programmes reflected the Bismarckian principles of autonomous social insurance institutions. In 1991, social insurance was enacted and the Estonian Social Fund (ESF) detached from the state budget (Supreme Council, 1990). Although according to the law, the ESF was a non-governmental institution, the government was heavily overrepresented on the fund's board whilst labour market partners were excluded (Government decree, 1991). The Social Fund paid numerous benefits – all kinds of pensions, child- and family allowances, incapacity for work benefits and unemployment allowances. The level of benefits and eligibility rules were set by the parliament and linked to the national minimum wage (Government decree, 1991).

Also in 1991, the national compulsory health insurance, together with the sickness funds in the counties became law (Riigikogu, 1991). Decentralised sickness funds were rather similar to the German system of health insurance, including the marginal role of the central government. Very soon, in 1994, the system was centralised into a single Central Sickness Fund (CSF) (Danilov, 2012). Beyond this centralisation move, the CSF retained the Bismarckian principles – it collected contributions and allocated them to the health care providers; sickness benefits were linked to the wage of the insured person.

Some aspects of the established system reflected communist legacies. Similar to other CEEWS (Leppik & Männik, 2002), the burden of insurance contributions in Estonia was not shared between labour market partners as characteristic of an ideal - typical Bismarckian regime, but put solely on the shoulders of the employers. In 1991, when the health insurance was in the making, the Supreme Council of Estonia[2] proposed to decrease the level of existing social contributions after the introduction of health insurance, and envisaged the division of health insurance contributions between the employer and employee (Supreme Council, 1991). Yet, these proposals were never put into law. The initial design of Estonian social insurance also ignored another fundamental principle of the Bismarckian system – linking contributions with benefits. In the 1990s, Estonia did not have individual social insurance accounts and the wage earned had no effect on pensions or other social benefits.

In a transitional country with a large shadow economy and poor tax enforcement capacity, it became clear quite soon that the existing arrangement could not provide the necessary means for welfare. In the mid-1990s, the government invested significant effort in stabilising the revenue side of its social policy. In conjunction with amendments to the Social Tax Act, the non-governmental Social Fund was reorganised into the government agency, the Social Insurance Board (Riigikogu, 1993). Through this change, the formerly autonomous ESF budget became part of the state budget. The Central Sickness Fund also experienced a decrease in its financial autonomy because from 1994 the collection of health insurance contributions was transferred to the national tax authorities. Yet, the management of the health care and sickness benefits budget remained under the CSF.

All the political parties in the 1990s were in agreement on the primary importance of tax policy and fiscal discipline. Within this broad consensus, party preferences differed in terms of how to achieve efficiency in financing welfare. The centrist party (KMÜ[3]) preferred to strengthen the role of labour market partners in social insurance funds (Coalition agreement, 1995). The neoliberals (Pro Patria[4]) saw the enhancement of individual responsibilities and opportunities as the best way to achieving efficiency in the welfare system (Laar, 2020). By the end of the 1990s, both political forces had achieved some success. An initial decision to reform pensions into a three-pillar-system was made in 1997 with a strong focus on individual and market-based solutions instead of occupational pension funds. In 2000, the Central Sickness Fund was transformed into the autonomous public Estonian Health Insurance Fund (EHIF). However, an explanatory memorandum to the bill on the Health Insurance Fund Act (Riigikogu, 1999) provides a mixed picture regarding the choice of welfare regime. On the one hand, the former government-dependant Central Sick Fund was transformed into a public body (EHIF), with the relevant management structure. The tripartite composition of the board, on the other hand, was justified by an argument in favour of participatory democracy and not social dialogue. The explanatory memorandum also states that "advancing participatory democracy is guided by the government, since the government appoints representatives of patients and medical workers to the board (Riigikogu, 1999, p. 2). In general, the dominant argument of institutional change was again the need for greater financial transparency and accountability instead of the effective inclusion of social partners.

The last brick in the Bismarckian foundation of the Estonian welfare state was laid at the turn of the Millennium with the introduction of unemployment insurance. Until then, social protection for workers was almost non-existent except for a monthly unemployment allowance of approximately 25 euros (Toots, 2006). The introduction of compulsory unemployment insurance-based on the shared contribution of employers and employees was saliently written into the governing programme of the broad right-left wing coalition (Coalition agreement, 1999) and enacted in 2001. Compared to pensions and health insurance, unemployment insurance resembles authentic Bismarckian principles of tripartism the most. Labour market organisations on both sides were actively involved in drafting the legal acts, which resulted in the decreased role of government in unemployment insurance management. Trade unions, employers' organisations

2 Supreme Council was a proto parliament inherited from the Soviet times and ceased to exist in 1992 after first free elections to the Riigikogu as the parliament of Estonian Republic

3 KMÜ, Koonderakonna ja Maarahva Ühendus – an electoral union of centrist technocrats and farmers; ceased to exist after 2000s

4 Pro Patria as a political party has experienced several merges, splits and ideological transformations. In 1990s when lead by Mart Laar it stood clearly at neoliberal positions, in 2000s moved towards conservative and nationalist positions.

and the government had equal representation in the management board of the Unemployment Insurance Fund (UIF), and decisions were made on the basis of qualified majority rule and no party had the power of veto (Riigikogu, 2001). Debates on insurance contribution rates were intense. The government proposed a contributions rate at a level that would allow benefits with 40–50% of the replacement rate, but employers and trade unions preferred a lower replacement level together with lower contribution rates. The proposal of the labour market partners was not accepted (Toots, 2006). In contrast to other social insurance schemes in Estonia, unemployment insurance contribution rates were set as flexible and shared more or less equally between workers and employers (0.5–2.8% of gross salary for workers and 0.25–1.4% of payroll for employers). The exact rate is negotiated by the tripartite UIF board and enacted by the government for four years (Riigikogu, 2001). As we will see later, this flexible arrangement that was initially meant to strengthen the power of the labour market partners proved to be the Achilles' heel of the system that allowed the government to override the social partners.

In parallel with unemployment insurance, another fundamental welfare reform was pursued by the parliament in 2001 – the introduction of mandatory funded pensions. The 'second pillar' aimed to complement the public PAYG pillar and the voluntary funded 'third pillar' both enacted in 1998. The bill (Riigikogu, 2001) changed the allocation of social insurance contributions, which marks an important breaking point with the principles of the conservative-corporatist welfare model. Previously, the entire revenue from social insurance (20% of the payroll) was under the control of the Social Insurance Fund; in other words, the Government. With the introduction of the mandatory funded pension pillar only 16% of social insurance contributions went into the public pension budget, whereas 4% was forwarded to the private banking sector according to the individual pension plans of insurers. As a result, the private sector and individual financial behaviour of employees gained substantial importance in the Estonian welfare state, whereas public social funds and occupational welfare arrangements lost importance.

Table 1: Main social protection schemes in Estonia, by year of legal introduction

Year	Ideological position	Governing coalition	Scheme	Financing principle	Governing institution	Governance principle
1991	Centre left/right	Popular Front + Coalition Party	all kinds of pensions, child- and family allowances, incapacity for work benefits, unemployment allowances	Social insurance	Social Fund (1991-93)	Government organisation with autonomous budget; Board appointed by the government, employers not included
1991	Centre left/right	Popular Front + Coalition Party	Health insurance, including sickness benefits	Social insurance	Regional Sickness Funds (1991-93); Central Sickness Fund (1994 -2000); Estonian Health Insurance Fund (from 2000 onwards)	Public body with tripartite board; all members nominated by the government; Minister of social affairs chairs and has decisive vote
1992	Centre right	Coalition Party	Child allowance	State budget	Social Fund (until 1994): Social Insurance Board (from 1994)	Government agency
1998	Centre right	Coalition Party + Development Party	Public pensions*, including disability**	Social insurance	Social Insurance Board	Government agency
2001	Grand coalition	Pro Patria +Reform Party, Moderates***	Unemployment insurance	Social insurance	Unemployment Insurance Fund	Public body with tripartite board, equal representation of parties, chair elected by the board, equality of votes
2001	Grand coalition	Pro Patria + Reform Party, Moderates	Mandatory funded pensions	Social insurance	Private pension funds	Intra-company regulations within the overall legal framework
2004	Centre right	Res Publica + Reform Party, People's Union	Parental leave benefit	State budget	Social Insurance Board	Government agency
2014	Right/left	Reform Party + Social Democrats	Incapacity for work allowance	State budget	Unemployment Insurance Fund	Public body with tripartite board, equal representation of parties, chair elected by the Board, equality of votes

Note: * before the Public pension act 1998, different temporary schemes of old age allowances existed in 1990s; **disability pensions were abolished in 2016 and replaced by incapacity for work allowances; *** Moderates is the former name of Social Democratic Party

Source: own elaboration

In summary, by the turn of the Millennium, the fundamental reforms of Estonian welfare state governance were accomplished. At the same time, these reforms remained the last building blocks of the Bismarckian model. The idea of introducing occupational pension funds in Estonia similar to Continental Europe was never realised. The same holds for work accident insurance, which occasionally still appears in party manifestos. In parallel with the deceleration of the Bismarckian path, neoliberal tendencies start to manifest themselves as the enactment of the three-pillar pension system had already demonstrated. The growing popularity of the neoliberal Reform Party accelerated these currents, whereas financing the welfare state through social insurance as set in 1991 counteracted them. The share of the main welfare receipts by contributors has not changed throughout all 25 years. Employers pay about 80% of the total budget (Eurostat, 2019), which is about 10% higher than typical in Western Bismarckian countries (Morel & Palme, 2013).

In 2004, Estonia together with nine other CEE countries became full members of the European Union. EU membership and the favourable economic climate boosted economic growth, which reached 8–10% annually in 2005–2008, making neoliberal ideas popular among voters. The neoliberal Reform Party won parliamentary elections three times in a row and governed Estonia for 11 consecutive years (2005–2016), having an important impact on the financing and governing of social insurance in Estonia.

Analysis: Towards direct state management of social insurance, 2009–2019

Existing literature claims that in periods of economic growth governments have little incentive to undertake radical social policy reforms because tax revenues are sufficient to cover social policy needs (Dukelow & Concidine, 2014). This was also true for Estonia in the first years after joining the EU. The situation changed totally when the 2008 financial crisis reached Europe. In the Baltic States, the crisis manifested itself a year later, but hit open economies in the region especially severely (Hay & Wincott, 2012). Estonian GDP fell by 3.7% in 2008 and by 14.3% in 2009; the unemployment rate between 2007 and 2010 rose from 4.6% to 16.7% (Kattel & Raudla, 2013). Quite naturally, the expenses associated with unemployment benefits skyrocketed and the UIF faced an annual deficit of €50 million (UIF, 2011). Besides recession, another important dynamic shaped the welfare reform trajectory in Estonia – the intention to join the Eurozone in 2011. The recession made EU fiscal policy even stricter and the European Commission together with the European Central Bank called for strengthening the economic dimension of the European social model (De la Porte & Pochet, 2014). Such an approach was very much in line with the agenda of the neoliberal Reform Party government, which could use it to legitimate hard domestic reforms. This situation created a 'critical juncture' where structural constraints became relaxed and expanded the range of plausible choices available to political actors. Let us look at whether these choices have materialised and whether this has occurred similarly in labour market policy (LMP) and health insurance?

On the eve of the recession, important changes in the institutional structure of the labour market policy were enacted. While drafting the amendments to the Labour Contract Act and Unemployment Insurance Act in spring 2008, social partners agreed to merge the government Labour Market Agency responsible for matching job seekers and employers with the Unemployment Insurance Fund (UIF), which so far only administered insurance benefits. The merger occurred in 2009 and as a result, the UIF became the only and universal body that paid benefits and provided services. The governance of UIF kept the former principle of tripartism but the structure of the fund's budget changed radically. Insurance contributions were now used also for non-contributory LM services (Riigikogu, 2008a) to become the dominant approach in Estonia's LMP. In 2011, a special fund for labour market services was created within the UIF budget. Besides the transfers from the state budget and the European Social Fund, 30% of the insurance contributions were moved here and made available for non-contributing job seekers.

Manipulations with UI contribution rates and benefit levels form another important set of adjustments made in the critical juncture of 2009. Initially, the amendments to the Labour Contract

Act and Unemployment Insurance Act (2008) foresaw increased flexibility in hiring and firing and extensions of unemployment compensation as proposed by the social partners. Yet, in summer 2009, the acts were rashly amended and put in force within two weeks (Riigikogu, 2009). Only those regulations that made firing and layoffs easier were enacted, whereas the planned increases in unemployment benefits were postponed. In parallel with curbing expenditures, the neoliberal government used its power position to increase the revenue side of social insurance (Raudla & Kattel, 2013). By government decrees (Government, 2009a; 2009b), the rates of unemployment insurance contributions were twice raised in 2009 up to the maximum level allowed by the law. In the same year, Prime Minister Ansip proposed halting government contributions to the second pillar pension funds until the economy had recovered. Despite disagreement with the Social Democrats and the Christian Democrats as coalition partners (Eesti Päevaleht, 2009), the amendments to the Funded Pensions Act and Social Tax Act were rashly adopted in summer 2009. As the Ministry of Finance (2009) explained, the objective of this measure was to retrench public expenditures and to give the government more flexibility in using the budget. Due to disagreements with such a harsh line, the Social Democrats left the government.

In 2009, cuts were implemented in health care as well. In the autumn, the contract between the Health Insurance Fund and health care providers was renegotiated, which lowered the price for hospital medical services by 6% but kept the number of services at the previous level (EHIF, 2009). The amendments to the Health Insurance Act and Occupational Health and Safety Act in summer 2009 decreased the replacement rate of sickness benefits from 80% to 70%, benefits for the first eight days were made the responsibility of employers instead of EHIF.[5] These changes were enacted jointly with the bill of the 2009 State Budget Amendment. Hence, changes in health insurance expenditures were justified by the tense fiscal situation as was the case with the unemployment and funded pension insurance. Haste in the proceedings and the neglect of labour market partners forced the Estonian Employers' Confederation to appeal to the Chancellor of Justice (CoJ). This office admitted that the employers' protest was justified because the transfer of sick leave payments to the employers conflicted with the constitutional principle of equal treatment (CoJ, 2009). However, the recommendation of the CoJ to revise the bill was not heard by the parliament.

Eurozone membership (from 1 January 2011) made domestic policy even more dependent on the public finance limitations set by the European Monetary Union and forced the next moves towards étatisation. Supported by the public euphoria about having the euro, the Reform Party once again won the parliamentary elections in March 2011 and continued governing with the same right-wing coalition. Fiscal sustainability was still important for them and in autumn 2011 the government announced the plan to consolidate the EHIF and UIF reserves to the state treasury. In this move the government aimed to acquire more freedom to manage the financial flows and improve the liquidity of the state treasury. The plan was met with angry protest by all parties – the boards of these funds, the Employers' Confederation (2011a), the Confederation of Trade Unions (Taliga, 2011) and the opposition parties. As in previous cases, the government acted from a position of power and carried out the decision in conjunction with the proceedings of the State Budget Act in the parliament. The Employers' Confederation reacted by withdrawing their representatives from the boards of EHIF and UIF (Employers' Confederation, 2011b). Yet, this had no effect on the governance of these funds because the system of qualified majority voting works well even if one party (out of three) withdraws their participation.

Consequently, by the 2010s, Estonia had openly declared the supremacy of sovereign debt and fiscal balance over the fundamental principles of social insurance, such as counting with the vested interests of contributors and the targeted use of insurance revenues. Instead of following the principle of the tripartite governance of social security, the government makes solo decisions that increase the financial burden of social partners without giving them more control over the revenues. The entire sequence of events marks an emerging path toward étatisation – the amendment of acts related to social insurance in conjunction with the state budget revision (2009), blurring the boundaries between contributory and non-contributory resources in the UIF budget (2011) and the consolidation of the reserves of the social funds into the state treasury (2011). The

5 Employers had to compensate sick leave from days fourth to eighth, compensation of days first to third was voluntary.

majority of these changes were carried out under the crises arguments that supports the thesis of 'critical juncture' as of a situation where relaxed structural constraints allow the central actors to make path-breaking changes. Yet, as we will see below, the move away from the Bismarckian welfare model continued after Estonia's recovery from the economic recession. Instead of the former straightforward retrenchment, the hidden increase of state control over the financing and administration of programmes becomes salient. The first important event along this path was the reform of disability pensions put on the agenda in 2012.

Disability pensions in Estonia were financed out of the overall pool of pension insurance contributions and benefits were linked to the insurance record of the person. Disability pensioners comprised about 10% of the country's working age population and growing expenditures on disability pensions put the sustainability of the public pension funds at risk (NAO, 2014). The annual deficit of the public pension funds (about 300 m euros) caused by the disability pensions, was covered by transfers from the state budget (Riigikogu, 2014a).

At first glance it seemed that there were two different approaches to the reform. First, in the framework of the state programme "Preparation of the incapacity for work insurance, 2012–2013" several studies were requested. Second, by April 2012, the government had decided that the eligibility criteria for incapacity for work will be residency and not social insurance (Riigikogu, 2014a). Yet, a reading of the studies makes it clear that the notion of 'insurance' is just a label and in fact there were no alternative scenarios. Furthermore, all the studies were requested by the government and there is no evidence of the involvement of social partners. This is also understandable because the social partners are not involved in the governance of the public pension fund.

The government decided (cabinet meeting 06.06.2013) that administering the new work disability system will be the responsibility of the UIF because the key idea of the reform is to facilitate the employment of disabled persons. Alternative options to create an entirely new body or to make the Social Insurance Board responsible for administering the system have been also considered (Riigikogu, 2014a). In line with the overall activation discourse, the relevant legal act was named as Work Ability Allowance Act (Riigikogu, 2014b).

As a result of the Work Ability Reform, the budget and tasks of the UIF were expanded substantially. The UIF started to assess the work ability of disabled jobseekers and provided individual counselling to them. Revenues for disability benefits were transferred from the public pension fund to the UIF, which increased the share of non-contributory receipts even further (Figure 1). From the beneficiaries' perspective, the policy change was also substantial. The former disability pensions took into account the number of years the person has participated in the social insurance scheme. The new system of work ability allowances, in force from 2016, grants benefits on the basis of the health conditions of a person instead of his or her contribution to social insurance (Riigikogu, 2014b). Pieters (2019) argues that such a departure whereby the disability pensions become non-contributory incapacity for work benefits is associated with the overall activation approach in social protection. The activation paradigm presumes that all those incapacitated for work should return to the labour market and policy measures need to be designed in line with this objective.

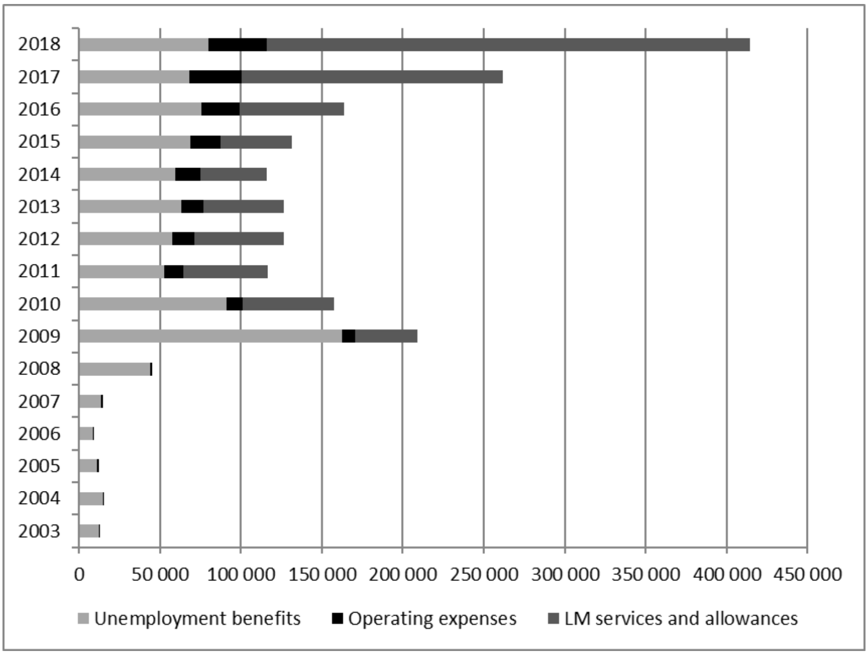

Figure 1: Unemployment Insurance Fund expenditures, 2003–2018, thousands EUR
Source: UIF Annual reports

As a result of substantial policy changes between 2009 and 2015, the balance of social funds was improved but did not eliminate the financial pressure on the insurance-based welfare system. This is the reason the Employers' Confederation in their manifesto[6] voiced their demands to lower social insurance contributions (Employers' Confederation, 2015). For a neoliberal government it was hard to utterly ignore this kind of proposal. Legally, it was easier to change the unemployment insurance contributions because this could be done by government decree. Consequently, the rates of unemployment insurance contributions were slightly decreased between 2013 and 2016. Establishing the ceiling for social insurance contributions or lowering the contribution rate entirely was more complicated because it required amendments to the Social Tax Act. Although the relevant promises were written into the coalition agreements (2014, 2015), they were never implemented.

In 2016, parliament passed a non-confidence vote against the Reform Party government, which ended the 11-year rule by the neoliberals. The new coalition government lead by the Centre party switched focus from the labour market to healthcare. The national insurance-based healthcare system had suffered for many years from financial stress because the health insurance contributions of the working population were insufficient to cover all the healthcare needs. So far, the EHIF budget was formed overwhelmingly out of health insurance contributions with state subsidies comprising only 1.4%. In 2017, the government decided to increase transfers to EHIF from general tax revenues to compensate the fund for providing healthcare to old age pensioners (Ministry of Finance, 2017). In addition, it was decided to consolidate some medical services (such as emergency medicine and vaccinations), which are financed by general tax revenues into EHIF (Ministry of Finance, 2017). Relevant amendments were made to the Health Insurance Act and the policy was implemented step-by-step between 2018 and 2020. Therefore, the share of non-contributory transfers in EHIF's budget is much less than transfers to UIF (8% and 55% respectively in 2018) (see Figures 2a and 2b). In parallel with the change in the revenues of the health care budget, the composition of the EHIF board has also been revised. The board, which previously

6 It has become a tradition that shortly before parliamentary elections the Employers' Confederation publishes "Employers' Manifesto" that reflects their proposals in main policy issues.

had 15 members, was cut to 6 and healthcare professionals were omitted (Government decree, 2018). Although the board composition still accords with the principles of tripartism, the power of government in the EHIF, which was relatively strong already, has been strengthened even more.

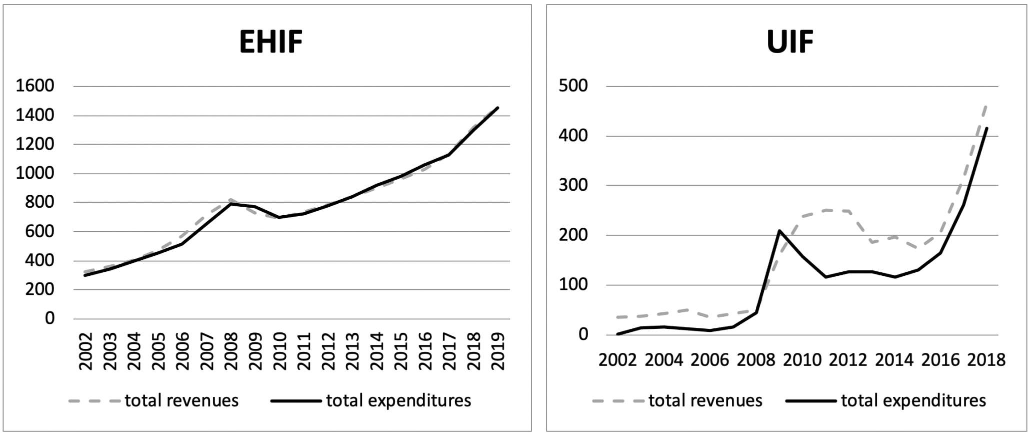

Figure 2: a) Revenues and expenditures of EHIF (on the left), b) UIF (on the right), 2002–2019, million euros
Source: EHIF and UIF Annual reports

Overall, very few interventionist measures made by the neoliberal government during the recession years were revised and the general approach to étatism remained intact.[7] Critical messages by the Chancellor of Justice (Madise, 2017) and the Auditor General (Holm, 2019) suggest that the unilateral actions of the government in using the reserves of the social funds are even intensifying. The "government's hand is deep in the employers' and employees' piggy bank," claimed the Auditor General, referring to the government's practice of using social insurance revenues to finance ongoing state expenditures (Holm, 2019). Proposals by employers to decrease the level of social tax and to share the burden between employers and employees (Employers' Confederation, 2018) remain neglected by policymakers.

Conclusion: Interpreting Estonia's path to welfare étatism

This article traced key episodes in reforms to major areas of social insurance in Estonia since the recession of 2008. Two analytical tasks were set: first, to see whether the reforms in Estonia, as a quasi-Bismarckian welfare state, mirror the reform trajectories of Western Bismarckian countries; and second, to find out whether the recession and accession to the Eurozone can be regarded as 'critical junctures', during which the choices of agents have triggered a path-dependent process in the domestic governance of social insurance.

The broad conclusion to the first question is that there is 'more state' in Estonian welfare governance today than at the turn of the Millennium, when the last building blocks of the Bismarckian welfare regime were put in place. Several characteristics of the changes to the governance of Estonia's social insurance in the 2010s mirror developments in Western Europe a couple of decades earlier. The common fundamental character of these changes involves a move towards direct state management of the social insurance system and a blurring of the boundaries between contributory and non-contributory schemes. At the same time, specific elements exist in the Estonian situation. Weak social partners and the absence of veto points in the law-making process allowed the government (more precisely – the ruling coalition party) to ignore labour market partners and constitutional monitoring institutions and behave in a more autocratic

7 Coefficients for medical services have been restored to the pre-crisis level in 2012, but sick leave compensation remained as set during the crisis. The extension of unemployment benefits, as foreseen in 2008, was never realized.

manner. By relying on the principle of theoretical consistency, one could expect that Estonia, similar to Western Bismarckian countries, would lower social insurance contribution rates as a quid pro quo choice for a bigger state role in social insurance governance. This choice was available and voiced by employer organisations during and after the recession, but was never realised. The government took more control of all the social insurance funds, keeping the rate of insurance contributions at the previous high level (except for some volatility in unemployment insurance). Perhaps an even more important factor behind why the government could act unilaterally is that decisions related to the social insurance funds could be made by the government cabinet through inferior policy instruments rather than through the decisions of the governing boards. Therefore, the regulatory tools for étatisation were already in place and waiting for the appropriate moment.

The second question requires us to revisit the methodology section on institutional change and critical junctures. The empirical analysis departed from the first assumption, that the key episode (trigger) may differ with respect to different institutions. According to the second assumption, one can observe a gradual institutional change but not a path-breaking 'critical juncture'. The findings revealed that the move towards direct state management has indeed occurred in distinct social insurance systems to various degrees. Étatisation is most visible in unemployment insurance, which was the latest and the purest building block of the Bismarckian welfare architecture in Estonia. Here the government moved from a simple change in contribution rates to the effective takeover of insurance contributions to co-finance extensive ALMP measures. The trigger episode of this trajectory was the transformation of the classical Unemployment Insurance Fund into a multifunctional agency for implementing the entire labour market policy. This institutional change facilitated the ensuing reform initiatives that further blurred the boundaries between contributory and non-contributory revenues, but also benefits and services. Importantly, the institutional merger was decided earlier than the economic crises hit Estonia. However, the economic recession and strict Eurozone criteria significantly relaxed institutional constraints and expanded plausible choices available to political actors, thereby creating a 'critical juncture' where a turn away from the two-tiered labour market policy was possible. The emerging path of consolidating all LM revenues and services into one multifunctional institution was fortified by the Work Ability Reform several years after the recession and Estonia's accession to the Eurozone. Hence, changes to LMP perfectly confirm the institutional-theoretical accounts, according to which 'critical junctures' are relatively short periods of time but they trigger durable path-dependant processes.

The Estonian Health Insurance Fund remained to a large extent intact until the Eurozone criteria became the top national priority and EHIF reserves were used to improve the overall national fiscal balance. Retrenchment measures adopted in 2009 were temporary and the scope of EHIF competencies did not change. Consequently, transfers from the state budget were smaller and access to sickness benefits or health services did not change at all. Nevertheless, the path to étatisation manifests itself here as well through the gradual strengthening of the government's role in managing EHIF, increasing transfers from the state budget and consolidation into EHIF of medical services financed out of general tax revenues. This means that in the case of EHIF, we have observed a gradual institutional change with no clear triggering event.

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Anu Toots is Professor of Social Policy at Tallinn University, Estonia. Her research focuses on the transformation of the welfare state in the era of political discontent and fiscalisation, politics and policies of social investment. Her recent publications include: Toots, A., & Lauri, T. (2022, in press). Nation (Re)building through Social Investment? The Baltic Reform Trajectories. In Garritzmann, J., Häusermann, S., & Palier, B. (Eds.) *The World Politics of Social Investment. Vol. II, The Politics of Varying Social Investment Strategies.* Oxford University Press.; Toots, A., & Lauri, T. (2017). Varieties of social investment policies on two sides of the Baltic Sea: Explaining routes to endurance. *Social Policy & Administration*, *51*(4).

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