STATUS AND PROSPECTS OF THE ESTONIAN ECONOMY 2026

Report of the Competitiveness Expert Council to the Riigikogu

Summary

September 2026

Introduction

At the end of 2023, the Economic Affairs Committee of the Riigikogu convened an expert panel to analyse the competitiveness of the Estonian economy and propose ways to improve it. The panel's first report was published in 2024, followed by a second in 2025. Both reports examined changes and trends in the global economy, assessed Estonia's competitive position relative to other countries, and explored several specific topics in greater depth. On the basis of these analyses, the Competitiveness Expert Council presented a set of policy recommendations in each report.

The panel's work is guided by the principle that national competitiveness should be examined on an evidence-based basis. It draws on the findings of international and Estonian research and applies them to developments in the Estonian economy and society more broadly. A country's competitiveness is shaped by the interaction of many factors. Some of these, such as geographical location and the global economic climate, are beyond the control of Estonian policymakers. Policy choices can, however, shape important foundations of competitiveness, including the business environment, people's knowledge and skills, physical and digital infrastructure, access to capital, and innovation capacity. These conditions enable firms to raise productivity and offer higher-value-added products and services, thereby supporting growth in incomes and well-being. The panel therefore focuses primarily on factors that can be influenced through decisions made in Estonia.

This third report, published in 2026, is divided into two parts. It opens with a review of the implementation of the recommendations presented in the 2025 competitiveness report. The first part analyses recent changes and trends in the global economy and assesses Estonia's competitive position relative to other countries. The second part examines in greater depth the role of management in the adoption of new technologies, the impact of cross-border interconnections on the electricity market, the use of financial instruments to finance businesses, and the outlook for Estonia's defence industry and platform economy. The panel's recommendations arising from these analyses are presented at the beginning of the report, before the substantive chapters.

Each chapter primarily reflects the views of its authors. Estonia's competitiveness and economic outlook are multifaceted subjects that can be approached from different perspectives, and members of the panel may therefore hold differing views on particular topics or interpretations. The recommendations presented in the report, however, are the joint work of the panel and are endorsed by all its members.

The panel comprises representatives of four institutions: Uku Varblane of the Foresight Centre, Kadri Männasoo of Tallinn University of Technology, Urmas Varblane of the University of Tartu, and Ülo Kaasik of the Bank of Estonia. A number of other experts also contributed to the panel's work. The report benefited from analyses and contributions by Mari Pärnamäe, Mari Rell, Martti Randveer and Liina Kulu of the Bank of Estonia; Priit Vahter, Maaja Vadi, Jaan Masso, Amaresh Tiwari, Anastasiia Pustovalova, Murad Ismayilzada, Liis Roosaar and Merle Erikson of the University of Tartu; Einari Kisel, Hannes Agabus and Mari-Klara Stein of Tallinn University of Technology; Hakan Berber, an independent economic researcher; Erkki Raasuke of the Estonian Business and Innovation Agency; Anne Sulling of Idee & Arendus; Tauri Tuvikene of Tallinn University; Kaire Holts of Westküste University of Applied Sciences; Annika Rosin of the University of Turku; and Olavi Miller and Tea Danilov of the Foresight Centre.

In preparing the report, members of the panel also met representatives of the Estonian Association of Construction Entrepreneurs, the Estonian Electronics Industries Association, the Estonian Chamber of Commerce and Industry, the Estonian Employers' Confederation, the Estonian Forest and Wood Industries Association, the Federation of Estonian Engineering Industry, and the Estonian Defence and Aerospace Industry Association.

The members of the panel wish to thank everyone who contributed to the preparation of the report.

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Recommendations of the 2026 report by the expert group on competitiveness

General observation:

- **Stronger support should be secured for long-term legislation and development plans.**
  Stronger political and public support and broader consensus are needed to implement long-term legislation and development plans. It is important for businesses that the Estonian regulatory environment be predictable and stable. This affects areas like energy policy and fiscal policy, but also for example forestry policy. It also makes it necessary for a single agreed line to be followed in public communication on foreign and economic policy.

Recommendations for foreign trade and industrial policy:

- **Recommendation 1: Support for exports should be aimed at diversifying the markets for them.**
  Priority should be given when support measures are designed and assessed to whether the efforts of the company involved will increase the number of destination markets for its exports and reduce dependence on a limited set of markets. It could be beneficial in the coming years to take advantage of the flexibility that a small country has and to focus above all on the internal European market and the potential of Central Europe, and to target the support measures of the Estonian Business and Innovation Agency and other support institutions more clearly towards export diversification.
- **Recommendation 2: The uneven impact on exporters of the Carbon Border Adjustment Mechanism (CBAM) and the parallel reduction in free emission allowances should be mitigated, and the administrative burden on importers should be reduced.**
  The Carbon Border Adjustment Mechanism should be applied in a way that reduces the uneven impact on exporters and makes reporting for importers as simple as possible.
- **Recommendation 3: Ways should be sought for the defence budget to contribute to Estonian competitiveness.**
  Orders and procurement for national defence, development programmes, and aid to Ukraine should simultaneously support Estonia's defence capabilities, the innovation capacity of businesses, and export potential. The state can do this by acting as an initial customer and using regulation that promotes development, developing dual-use solutions, and taking total life-cycle costs into account in procurement. A good example of this approach is the defence round of the applied research programme.

Recommendations for financing for companies:

- **Recommendation 1: Public sector financial instruments should be given a clear mandate and portfolios should be managed in terms of their actual risk.**
  The goals, risk tolerance and expected impact of financial instruments should be clearly stated and the portfolio should be managed on the basis of actual risk, rather than solely on whether individual projects meet formal eligibility criteria. This requires the implementing bodies to develop skills in risk-based portfolio management and in assessing more complex investment cases. Overlapping support and funding schemes should be consolidated to make the funding system less fragmented and funding for different stages of development should be linked together to provide support for businesses along their entire path.
- **Recommendation 2: Financing for complex projects should be accompanied by advisory support.**
  Financing for projects involving higher technological, export or investment risks should be accompanied by substantive advisory support to support the quality of the project and reduce the risk of loans and guarantees being given to businesses whose actual problems are not financial.

Recommendations for energy policy:

- **Recommendation 1: Energy policy should be focused less on individual sources of energy and more on the efficiency of the energy system as a whole, with cross-border interconnections and local capacities working as solutions that support one another.**
  The main priority in energy policy should be moved away from favouring individual sources of energy towards the functioning of the energy system as a whole, for example, by monitoring capacity utilisation.
- **Recommendation 2: The actual cost of security of supply should be reflected in the end price of electricity.**
  Security of supply should be treated as a separate and important component of the final price to consumers of electricity. This needs a balance to be found between the capacity of society to pay for it, the financial capacity of the state, and economic viability.

- **Recommendation 3: The actual readiness of private capital to invest in developing capacity and the need for public funding should be assessed.**
  How ready and able private capital is to invest should be assessed when new generation and dispatchable capacity is planned, together with when the need for public financing or long-term government commitments will arise. Technologies with different risk profiles need different support schemes.
- **Recommendation 4: Domestic renewable and low-carbon dispatchable energy production should be developed through the use of biogas and combined heat and power generation.**
  The production and use of biogas should be considered as part of the planning for gas-fired power plants, district heating and cogeneration. A realistic solution requires joint planning of heating and electricity generation to increase domestic dispatchable energy production and reduce system risk, taking existing investments into account.

Recommendations for encouraging innovation at companies:

- **Recommendation 1: Support for technology, innovation and digitalisation should be linked to the development of management capacity.**
  Technological innovation needs strong management capacity and organisational innovation if it is to have a major impact. Support measures for businesses consequently need to aid not only investment in technology, but also management quality, organisational innovation, and skills in technology management. Attention should be paid to managers and middle managers at small and medium-sized enterprises (SMEs).
- **Recommendation 2: Skills in coordination, training, coaching, quality control and problem-solving should be developed to meet demand resulting from automation and technological innovation. This makes it important to:**
  - **strengthen skills in training and coaching, coordination, and quality control in vocational education, further education and internal training programmes within businesses;**
  - **support training initiatives that develop social, cognitive and technological skills, such as cooperation and problem-solving skills together with data-based decision-making or the use of digital tools;**
  - **plan practical retraining programmes for workers with low qualifications that combine social, cognitive, practical and technical skills.**
- **Recommendation 3: Access to support services for businesses should be ensured outside the large population centres.**
  Businesses based outside large population centres need locally accessible support, but the new strategy of the Estonian Business and Innovation Agency is directed towards large focus clients. This means that regional development centres and the role of business advisers at local governments need to be strengthened so that small regional companies are not shut out from the support system. Consultation could direct companies more than before towards practical micro degrees and other flexible forms of study.
- **Recommendation 4: Sharing of experience and best practice between companies should be maintained and developed, including through cooperation networks, mentoring and clusters.**
  Permanent forums for cooperation are needed for businesses to share experience and best practice with one another. Cooperation, mentoring and networks should be maintained and developed based on clusters alongside the logic of leading companies, as they also help spread knowledge among smaller companies and across regions.

Recommendations for the platform economy:

- **Recommendation 1: Regulatory clarity should be provided about the legal status of people engaging in platform work.**
  Practical guidelines for assessing subordination and hierarchy, an understandable procedure for appeals, and effective supervision should be put in place. If a platform treats workers as entrepreneurs, those workers should have the rights of entrepreneurs, including the ability to decide their own prices, working time and client list. The legal status could be assessed by the Labour Inspectorate within the supervision process.

Chapter Summaries

1. Looking at Developments in the World and Estonia: Operating Environment and Trends

- At the start of 2026, the global economy appeared to be moving towards a moderate recovery, supported by rapid growth in technology investment, easing inflation and stabilising interest rates. The outbreak of the military conflict involving Iran slowed the recovery, although the impact has so far been smaller than initially feared.
- The outlook depends above all on how long disruptions to transport corridors and energy supplies persist and how much inflationary pressure they generate.
- The operating environment has become exceptionally volatile. Uncertainty now arises not only from formal policy decisions but also from political communication, which can change market expectations immediately.
- Current security and energy risks amplify longer-term trends: slower global growth, weaker capital flows, and a stronger policy preference for economic autonomy, security of supply and strategic support for selected industries. For Estonian firms, these risks quickly affect export demand, financing conditions and willingness to invest.
- Four connected trends will shape the near-term environment: sharp fluctuations in energy and logistics costs, a higher cost of capital, fragmentation of international trade, and rising investment related to artificial intelligence.
- Estonia cannot improve its competitiveness by relying only on a recovery in external demand or on a single sector to lead growth. The central issue is whether firms can invest in employee skills, automation, new technologies and energy efficiency.
- The main risk is that uncertainty and expensive capital delay necessary investment. The same environment may create opportunities if European defence and digital investment can be linked to higher productivity and export capacity in Estonia. An energy-supply shock may also accelerate technological renewal and innovation.

2. A Closer Look at the Estonian Economy: Export Performance, Market Share and Price and Cost Competitiveness

- Estonia lost some ground in its convergence towards the European average in terms of relative prosperity in 2025. Measured by GDP per capita in purchasing power parity terms, Estonia ranked 20th in the European Union, one place lower than previously, after Poland moved ahead.
- Estonia lagged somewhat behind broader developments in the global economy over the preceding two years. In 2025, the economy began to recover from this relatively prolonged period of underperformance, and the volume of foreign trade increased by 5%.
- Exports recovered in 2025, supported by both cyclical and structural factors. Stronger external demand boosted goods exports, with manufacturing making an important contribution. Services exports continued to grow, driven by increased exports of ICT and business services.
- Estonia's export market share declined substantially in 2023–2024. Export performance improved considerably in 2025, enabling Estonia to maintain its market share.
- Export growth in 2025 was driven primarily by trade with Central Europe, particularly Germany and Poland, as well as Lithuania. In the coming years, the European internal market offers considerable potential for diversifying Estonia's export destinations and finding new trading partners.
- Upward pressure from raw-material and production-input prices eased in 2025, contributing to some improvement in Estonia's price competitiveness. The terms of trade also improved in manufacturing.
- Pressure from rising labour costs has eased. Labour-cost growth was considerably slower in 2025 than in previous years. Estonia's nominal unit labour costs increased by 3.3%, a slower rate than in Latvia and Lithuania.

3. Estonia's Economic Competitiveness Compared with Lithuania Latvia and Finland

- Estonia and Lithuania have followed similar development paths, but Lithuania's economy has grown faster in recent years. Lithuania has caught up with Estonia in productivity and moved ahead in several fields.

- Lithuania has benefited from more diversified export markets that are better aligned with demand in Central and Western Europe. Its economy is also more diversified, and the state has supported industry and major investment more actively through tax incentives and regional policy.
- Estonian firms have moved towards more complex, knowledge-intensive products and services. Business expenditure on research and development is considerably higher in Estonia than in Lithuania. In 2024, business-sector R&D expenditure equalled 1.19% of GDP in Estonia, compared with 0.43% in Lithuania, 0.33% in Latvia and 2.19% in Finland.
- Estonia's key challenge is to turn this greater knowledge intensity into innovative products, services and export success. Estonia's services exports are more knowledge-intensive, but Lithuania earns substantially more in total from less knowledge-intensive services.
- Competitiveness cannot be assessed solely through GDP growth and income levels. Estonia has invested more over time in education, research and development, and health, reflected in stronger educational outcomes and longer life expectancy. These investments support long-term competitiveness even when the effect is not immediately visible in economic growth.
- Lithuania is increasing investment in human capital and narrowing the gap with Estonia. Both countries must balance rising defence expenditure with continued investment in education, research and health.

4. Prospects for Estonia's Defence Industry as European Defence Needs Grow

- Estonia is well placed for rapid development of its defence industry. European countries are expected to spend almost EUR 1 trillion more on defence equipment over the next decade, about half of it procured within Europe, while Estonia has innovative technological solutions to offer.
- The main risks are protectionism, which can be mitigated through joint projects and investment with partner countries, and labour shortages, which may constrain the sector if growth is very rapid.
- In addition to providing a stable and development-friendly environment, the Estonian state should act as a first customer for domestic defence products. This would shorten feedback and development cycles and provide an important reference for exports.
- Members of the Estonian Defence and Aerospace Industry Association generated EUR 730 million in defence-related revenue in 2025, 45% more than a year earlier, and exports accounted for 62%. The report's scenarios place sector revenue in 2030 between EUR 1.8 billion and EUR 4.7 billion.

5. The Impact of Cross Border Interconnections on the Electricity Market

- Estonia lies on the edge of the Nordic-Baltic electricity system. It lacks direct access both to low-cost renewable electricity in the Nordic region and to the large market in Central Europe, creating a continuing trade-off between self-sufficiency and electricity trade.
- Poland and Estonia have the highest shares of fossil fuels in electricity generation in the Nordic-Baltic region. Latvia and Lithuania have moved ahead of Estonia in the share of renewable energy.
- Storage, digital demand management and new business models can align consumption more closely with supply and reduce intraday demand volatility. Demand would increase especially during low-price hours with abundant wind and solar generation.
- Solar generation is negatively correlated with electricity demand, while wind generation is positively correlated. Because Estonia has a higher share of solar and a lower share of wind than Finland, its renewable generation is negatively correlated with demand, whereas Finland's is positively correlated.
- As renewable generation expands and demand becomes more flexible, the utilisation of gas-fired peaking plants and peak prices decline. EstLink 3 would sharply reduce the ability of such plants to enter the market.
- If electricity demand in Estonia adjusts to the availability of solar and wind power, the development of EstLink 3 would be beneficial and could reduce the final price paid by consumers by EUR 25–30 per MWh. If demand does not adjust to variations in solar and wind generation, however, a rising share of these energy sources may not lower the final consumer price and could even cause it to increase. This is because additional support would be required for gas-fired peaking plants and domestic solar and wind farms, which would face strong competition both from additional domestic renewable generation and from imported nuclear and hydropower delivered through the interconnection.
- Assuming an increase of 30–50% in total electricity consumption – equivalent to average hourly consumption of 1,300–1,500 MWh across all 8,760 hours of the year – raising the share of solar and wind power to 60–70% could generate estimated annual savings of nearly EUR 300 million for final consumers.

- The overall economic benefit would be even greater when accounting for the effect of competitively priced electricity as a production input on value-added growth.

6. Public Financial Instruments for Financing Business Growth

- Public financial instruments should not replace banks or private investors. Their role is to share risk, extend the financing horizon and mobilise private capital for projects that would otherwise not proceed or would be smaller.
- Bank lending suits many firms, but collateral-based debt may be inappropriate for innovation, intangible assets, exports and large investment projects.
- In spring 2026, outstanding bank loans to companies exceeded EUR 11.5 billion, while cumulative investments by Estonia-registered investment funds in domestic non-financial firms were about EUR 811 million. This illustrates the continuing dominance of bank finance.
- The cost of capital in Estonia reflects the small market, concentration in banking and geopolitical risk.
- Grants and financial instruments serve different purposes. Grants are suitable for early-stage R&D, public goods and activities with highly uncertain outcomes. Loans, guarantees, export credit insurance and equity instruments are suitable when a project can generate future income but the private sector will not carry the full risk.
- The largest financing gaps concern commercialising innovation, scaling medium-sized firms, entering export markets, major industrial and defence investment, and regional firms with insufficient collateral.
- Business financing in Estonia is fragmented. The Estonian Business and Innovation Agency, SmartCap, KredEx Krediidikindlustus, the Rural Development Foundation, banks, funds and European financial institutions should form one coherent system from the entrepreneur's perspective.
- Reform should focus on a clear growth pathway for firms, better leverage of private capital, more risk-sensitive use of guarantees, and evaluation based on outcomes rather than disbursements. Objectives, risk tolerance and expected impact should be explicit, and portfolios should be managed according to actual risk.

7. Regional Distribution and Terms of Corporate Loans in Estonia

- The analysis finds no broad regional gap in corporate borrowing activity. Outside Harju County, the share of property-backed corporate lending is not systematically low relative to the regions' shares of firms and sales revenue.
- Regional differences are driven more by business structure than by location. Firm size, sector, purpose of the loan and type of collateral explain a large part of the variation.
- Loan terms across regions have converged since 2019, with Ida-Viru County the exception. In 2026, average loan margins for small, medium-sized and large firms there were about 60 basis points higher than for loans secured in Northern Estonia. Past payment performance does not explain the difference.
- Greater competition in banking may explain the convergence and improvement in loan terms. However, data on issued loans do not capture rejected applications or firms that decided not to seek finance.

8. Economic Impact of the Carbon Border Adjustment Mechanism

- Between 2026 and 2034, free EU emissions allowances in carbon-intensive sectors exposed to a high risk of carbon leakage will gradually be replaced by the Carbon Border Adjustment Mechanism (CBAM). Initially, this applies to selected products, while other sectors retain the existing free-allocation system until 2030.
- CBAM improves the position of EU producers in the internal market because competitors from third countries must bear a carbon cost comparable to that paid in Europe.
- At the same time, it raises costs for European producers using imported inputs and weakens the competitiveness of EU exporters in third-country markets. The largest adverse effects occur in sectors that lose free allowances.
- Studies suggest that CBAM, together with the reduction in free allowances, reduces carbon leakage without causing major damage to aggregate European economic growth. However, the impact may vary considerably across countries and is likely to be greatest in sectors that do not benefit from the CBAM but lose substantial price competitiveness as free emissions allowances are phased out.

- The actual impact depends on policy design, including allowance-price formation under the EU Emissions Trading System, calculation of embedded emissions in imports, the implementation schedule, product coverage and possible compensation of carbon costs for exports. Trading-partner responses and the wider development of global climate policy also matter.
- If CBAM had been fully applied to Estonia's 2025 imports, the additional cost is estimated at about EUR 70 million, or 0.3% of total goods imports. If Estonia's shale-oil industry had had to purchase allowances in 2025, the estimated cost would have been EUR 134 million, equivalent to 40% of the sales revenue of the relevant industry group.

9. Impact of Technological Innovation on Productivity in Estonia: Management Capability, Path Dependence and Employees' Social Skills

- Adopting new technology alone does not guarantee substantial productivity growth. Results depend on whether a firm also updates work organisation, management practices and decision-making and develops employee skills. Treating innovation only as a new product or technology overlooks a large part of its productivity potential.
- An impact analysis using Estonian firm data found that automation alone raises productivity by about 6–9%, while the effect can reach 24% when combined with organisational innovation. Artificial intelligence produced no statistically significant productivity increase without organisational innovation. When combined with it, AI raised estimated productivity by 19% in manufacturing and 23% in knowledge-intensive services.
- Technological development is strongly path-dependent. Previous innovation experience and higher productivity make firms more likely to adopt new technologies, allowing successful firms to widen their lead and potentially deepen productivity gaps.
- Productivity differences between Estonian firms are strongly associated with investment in internally created intangible assets, including organisational, R&D and ICT capital. Such investment is, on average, substantially lower than in the Nordic countries.
- Automation increases the value of employees' social and coordination skills. Jobs that combine social, cognitive, practical and technical skills command particularly high wage premiums.
- Technology and innovation support should therefore be linked to management capability, organisational innovation and employee skills. Reducing productivity gaps also requires stronger domestic and international knowledge transfer from frontier firms through mentoring, collaboration networks and industry associations.

10. Platform Economy and Estonia's Competitiveness

- Estonia's main opportunity in the platform economy is to build internationally scalable technology and platform companies and make high-skill online work an export channel for services.
- Location-based platform work improves short-term labour-market flexibility and access to services.
- Regulatory clarity is essential. Practical guidance is needed for assessing subordination, together with a clear process for challenging algorithmic decisions and effective supervision. If a platform treats a worker as an entrepreneur, the worker must retain entrepreneurial rights, including the ability to set prices and working hours and manage a client base.
- The study also identifies longer-term risks. Nineteen per cent of regular ride-hailing and delivery workers, an estimated 1,500 people, were working full time in jobs for which they considered themselves overqualified. Around one quarter of weekly workers reported at least 50 hours of platform work per week.