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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plans of Estonia

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of Estonia

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1. INTRODUCTION

Estonia submitted its Draft Budgetary Plan for 2017 on 17 October 2016 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Estonia is subject to the preventive arm of the Pact and should preserve a sound fiscal position which ensures compliance with the medium term budgetary objective (MTO).

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission Forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2016 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2016-2017 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact (SGP). Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council on 12 July 2016, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The Ministry of Finance's macroeconomic forecast, which is incorporated in the Draft Budgetary Plan (DBP) for 2017, was published on 15 September. Estonia's real GDP growth reached 1.4% in 2015 and is projected by the Ministry of Finance to remain low at 1.3% in 2016, but to accelerate to 2.5% in 2017 on the back of rebounding investments and a rise in exports as the external environment is assumed to improve. The forecast for both 2016 and 2017 has been revised downwards compared to the Stability Programme presented in spring 2016. The main reasons are delays in public investment for 2016 and an assumed destocking in 2017, which has a negative impact on GDP growth.

According to the DBP forecast, domestic demand is expected to remain the main growth driver in 2016 and 2017. The unemployment rate is projected in the DBP to increase notably from slightly above 6% in 2016 to above 7% in 2017, which can be linked to the introduction of the 'work ability' reform bringing work-incapacity retirees back into the labour market. Wage pressures remain substantial due to a tight labour market and decreasing population at working age. HICP inflation has already started to increase in the second half of 2016 and is projected to go up to almost 3% in 2017, mainly driven by global energy prices and notably a boost in excise duties.

This scenario is broadly in line with the Commission 2016 autumn forecast, which expects slightly lower real GDP growth for 2016 at 1.1% and 2.4% in 2017. However, as the main tax bases (consumption and labour market) are projected to develop similarly there are no significant differences in public finances. Overall, the DBP’s outlook is based on plausible macroeconomic projections.

Box 1: The macro economic forecast underpinning the budget in Estonia

The macroeconomic forecast underlying the Draft Budgetary Plan was prepared by the Fiscal Policy Department in the Ministry of Finance of Estonia and was endorsed by the Fiscal Council, which is an independent body. The Fiscal Council is an advisory body charged with assessing Estonia's fiscal policy. It is attached to the Bank of Estonia and consists of six members with high reputation and experience. The Council assesses the macroeconomic and fiscal forecasts of the Ministry of Finance and to what extent the budget rules are followed, in accordance with the requirements of the State Budget Act and the European Union law.

On 29 September 2016, the Fiscal Council published an opinion[1] on its website on the macroeconomic and fiscal forecasts of the Ministry of Finance. The Fiscal Council considers that the Ministry's downward revision of GDP forecast for 2016 and 2017 is appropriate. However, it argues that some risks relate to the export forecast, arising from optimistic external demand assumptions and Estonian ULC growth. At the same time, the Fiscal Council noted that the forecast assumes a continuation of strong growth in wages and private consumption, but when budgeting for the longer term, it cannot be expected that the growth in the main tax bases will continue to exceed GDP growth. The Fiscal Council also highlighted measurement uncertainty of the estimates of the output gap and the structural budgetary position given the contradicting performances of the labour market and GDP growth. According to the Fiscal Council’s own 'disaggregated' output gap method[2], the Estonian economy may already be operating above its potential and in contrast with the Ministry of Finance estimates, the budget might actually be in structural deficit in 2016-17. Taking account of the above-mentioned uncertainties, the Fiscal Council recommends that the state budgets set a target of a small structural surplus for 2017.

[1] http://eelarvenoukogu.ee/files/Opinion%20Summer%20Forecast%202016.pdf

[2] The disaggregated output gap method considers also gaps in those economic variables which affect tax revenues directly, i.e. private consumption gap and payroll gap.

Table 1. Comparison of macroeconomic developments and forecasts

	2015	2016			2017		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.4	2.0	1.3	1.1	3.0	2.5	2.3
Private consumption (% change)	4.7	3.4	3.3	3.3	2.5	2.7	2.9
Gross fixed capital formation (% change)	-3.3	2.4	1.2	3.2	4.4	6.8	5.3
Exports of goods and services (% change)	-0.6	1.6	2.7	2.7	3.8	3.5	3.3
Imports of goods and services (% change)	-1.4	3.7	5.0	4.9	3.8	3.7	4.2
Contributions to real GDP growth:							
- Final domestic demand	2.3	2.7	2.1	2.5	2.7	3.2	3.0
- Change in inventories	-1.6	0.8	0.7	0.2	0.1	-0.6	-0.3
- Net exports	0.6	-1.6	-1.6	-1.6	0.1	0.0	-0.5
Output gap[1]	1.2	-0.7	0.1	-0.1	-0.4	0.0	-0.4
Employment (% change)	2.9	-0.9	0.9	1.2	-0.1	-0.1	0.2
Unemployment rate (%)	6.2	6.6	6.2	6.5	7.6	7.2	7.4
Labour productivity (% change)	-1.4	2.9	0.4	-0.1	3.1	2.6	2.1
HICP inflation (%)	0.1	0.9	0.9	0.8	2.9	2.9	2.6
GDP deflator (% change)	1.0	2.1	1.8	3.7	2.9	2.6	3.0
Comp. of employees (per head, % change)	5.7	5.1	5.1	6.1	4.5	5.2	5.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.2	3.1	2.9	3.2	3.2	3.4	3.1

Note:

[1] In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

Estonia's DBP projects the general government surplus to increase from 0.1% of GDP in 2015 to 0.3% of GDP in 2016 (Table 2). The projection for 2016 shows a significant improvement compared to the 2016 Stability Programme (which expected a deficit of 0.4% of GDP), mainly due to better-than-expected labour tax income (reflecting stronger than expected wage growth) and lower investment expenditure due to delays in investment programmes, including EU funded projects for the new programming period. At the same time, public wage costs and social expenditure have grown faster in 2016 than expected in the Stability Programme. The delays in EU funded projects also impact the revenue side via lower transfers from the EU to Estonia.

In 2017, the general government balance is projected to turn into a deficit of 0.6% of GDP, 0.1 pp worse compared to the target set in the Stability Programme. While revenues are expected to remain strong overall in 2017, the weakening mainly reflects the assumed strong increase in investment expenditure. EU-funded projects from the new programming period are assumed to start being implemented and 2017 is a local election year, normally associated with higher investments. Compared with the Stability Programme, the 2017 draft budget includes some new social measures. Also, expenses related to the Estonian EU Council Presidency were brought forward due to the earlier start of the Presidency. In the case of Estonia, the low interest environment has no significant impact on the fiscal outcome, as the country's debt level is the lowest in the EU at about 10% of GDP and interest expenditure amounts to only 0.1% of GDP.

The recalculated[3] structural balance is estimated to weaken from a surplus of 0.5% of GDP in 2016 to a deficit of 0.2% of GDP in 2017[4]. While the Stability Programme foresaw a weakening of the structural balance by 0.2 pps., the new fiscal path included in the DBP indicates a decline of 0.7 pps. This change can be largely explained by the effect of the delay in investment expenditure from 2016 to 2017 (improving the balance in 2016, but weakening in 2017), and the above-mentioned social spending and EU Council Presidency expenses.

The Commission 2016 autumn forecast projects a slightly higher headline surplus of 0.5% of GDP in 2016. The 0.2% of GDP difference with the DBP is due to more optimistic revenue projections for 2016, based on the latest available budget performance data from September 2016. The comparative figures in Table 2 are given as a percent of GDP and the differences largely reflect the denominator effect, as the Commission forecast assumes a higher GDP deflator[5] for 2016. In absolute terms, the Commission and the Ministry of Finance have rather similar projections of the main revenue and expenditure components, with the Commission expecting slightly higher revenue from labour taxes in 2016-17. A large difference concerns two related categories: 'other (residual)' revenues and expenditures, where the Commission assumes a somewhat smaller drop in EU-funded projects in 2016 (these are recorded both in the revenue and expenditure side). Due to the more positive starting point in 2016, the Commission also projects a slightly lower deficit for 2017. At the same time, the Commission's structural balance projections are similar for 2016 and 2017, impacted by differences in output gap estimates and a somewhat different assessment of one-off measures.

Overall, the risks to the DBP fiscal targets are assessed to be balanced. Implementation risks for 2017 appear low as most of the tax measures have already been legislated. Notably, excise duties are raised significantly over 2016-2018. Specific risks related to excise duties collection can be considered as balanced, as the projections already take into account a negative impact on the volume of excise goods sold due to higher prices and cross-border trade. A potentially significant negative risk is related to the assumed continuation of relatively rapid growth of the main tax bases, namely wages and accompanying household consumption. Considering that labour taxes account for 45% of revenues, an unexpected slowdown in wage growth would in itself significantly affect revenues. The Estonian Fiscal

[3] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

[4] The targets of the DBP at face value, as published by the national authorities, indicate a structural surplus of 0.2% of GDP, which complies with the national fiscal rule of structural balance or surplus.

[5] While the GDP deflator is projected significantly higher for 2016 by the Commission, this is largely due to export and import price assumptions and does not play a major role in terms of tax bases.

Council has drawn attention to the same risk. The above risks are somewhat mitigated by the good track record of Estonia in meeting and often even exceeding its budgetary targets.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2015	2016			2017			Change: 2015-2017
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**40.5**	**40.4**	***40.0***	**40.3**	**40.2**	***40.0***	**40.2**	**-0.5**
of which:								
- Taxes on production and imports	14.5	15.1	*15.1*	14.9	15.0	*15.3*	15.0	0.8
- Current taxes on income, wealth, etc.	7.9	7.6	*7.8*	7.7	7.3	*7.7*	7.5	-0.2
- Capital taxes	0.0	0.0	*0.0*	0.0	0.0	*0.0*	0.0	0.0
- Social contributions	11.6	11.6	*11.9*	11.7	11.3	*11.8*	11.6	0.2
- Other (residual)	6.5	6.1	*5.2*	6.0	6.6	*5.2*	6.2	-1.3
Expenditure	**40.3**	**40.8**	**39.6**	**39.9**	**40.7**	**40.6**	**40.6**	**0.3**
of which:								
- Primary expenditure	40.2	40.7	39.5	39.8	40.6	40.5	40.5	0.3
of which:								
Compensation of employees	11.5	11.3	11.8	11.6	11.2	11.8	11.6	0.3
Intermediate consumption	6.8	6.8	6.9	6.8	7.0	7.0	6.7	0.2
Social payments	13.5	13.3	13.7	13.7	13.5	13.9	14.0	0.4
Subsidies	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.0
Gross fixed capital formation	5.4	5.2	4.2	4.3	5.8	4.9	4.9	-0.5
Other (residual)	2.7	3.7	2.5	2.9	2.7	2.5	2.9	-0.2
- Interest expenditure	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
General government balance (GGB)	**0.1**	**-0.4**	**0.3**	**0.5**	**-0.5**	**-0.6**	**-0.4**	**-0.7**
Primary balance	**0.2**	**-0.3**	**0.4**	**0.6**	**-0.4**	**-0.5**	**-0.3**	**-0.7**
One-off and other temporary measures	-0.3	-0.3	-0.3	-0.1	-0.3	-0.4	0.0	-0.1
GGB excl. one-offs	**0.4**	**-0.1**	**0.6**	**0.6**	**-0.2**	**-0.2**	**-0.4**	**-0.6**
Output gap[1]	1.2	-0.7	0.1	-0.1	-0.4	0.0	-0.4	-1.3
Cyclically-adjusted balance[1]	-0.4	-0.1	0.2	0.5	-0.3	-0.6	-0.2	-0.1
Structural balance (SB)[2]	**-0.1**	**0.2**	**0.5**	**0.6**	**0.0**	**-0.2**	**-0.2**	**0.0**
Structural primary balance[2]	0.0	0.3	0.6	0.7	0.1	-0.1	-0.1	0.0

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3.2. Debt developments

According to the DBP, general government gross debt is projected to increase from 9.6% of GDP in 2016 to 10.3% of GDP in 2017[6] (see Table 3). The 2017 figure is somewhat higher than in the Commission 2016 autumn forecast, as the DBP also appears to includes some financial transactions (beyond the usual financing of budget deficit). The Commission

[6] At the same time, the general government has over time accumulated sizeable reserves of liquid financial assets, amounting to 9.4% of GDP at the end of 2015.

forecast did not include an assumption on these very specific items as they are uncertain and depend on developments over the course of 2017.

Table 3. Debt developments

(% of GDP)	2015	2016			2017		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**10.1**	**9.6**	**9.6**	**9.4**	**10.4**	**10.3**	**9.5**
Change in the ratio	-0.6	-0.5	-0.5	-0.7	0.8	0.7	0.2
Contributions[2] *:*							
1. Primary balance	**-0.2**	**0.3**	**-0.4**	**-0.6**	**0.4**	**0.5**	**0.3**
2. "Snow-ball" effect	**-0.2**	**-0.3**	**-0.2**	**-0.4**	**-0.4**	**-0.4**	**-0.4**
Of which:							
Interest expenditure	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Growth effect	-0.2	-0.2	-0.1	-0.1	-0.3	-0.2	-0.2
Inflation effect	-0.1	-0.2	-0.2	-0.3	-0.3	-0.2	-0.3
3. Stock-flow adjustment	**-0.2**	**-0.5**	**0.2**	**0.3**	**0.8**	**0.6**	**0.3**
Of which:							
Cash/accruals difference							
Net accumulation of financial							
of which privatisation proceeds							
Valuation effect & residual							

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

The DBP presents only those discretionary measures which were announced by the government in the draft budget (see Table 4), leaving out changes already legislated or decisions taken at an earlier stage, such as in the Stability Programme. According to the authorities, the measures have a net deficit-increasing effect of 0.1% of GDP in 2016, and a deficit decreasing effect of 0.2% of GDP in 2017. In essence, the new measures foresee a one-off sale of 5G mobile network licences in 2017 (0.07% of GDP) and a group of several other small measures. The revenues from the sale of 5G network licences have not been included in the Commission autumn forecast due to some uncertainties about its revenue impact in 2017. The group of measures includes 16 various minor measures, some of which shift items between the 2016 and 2017 budgets.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2016	**2017**	**2018**
Taxes on production and			
Current taxes on income,	-0.1	0.1	0.0
Capital taxes			
Social contributions			
Property Income	0.0	0.1	0.0
Other			
Total	-0.1	0.2	0.0

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2017

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2016.0	**2017.0**	**2018.0**
Compensation of employees	0.0	0.0	0.0
Intermediate consumption	0.0	-0.1	0.0
Social payments			
Interest Expenditure			
Subsidies			
Gross fixed capital formation	0.0	0.1	0.0
Capital transfers			
Other			
Total	0.0	0.0	0.0

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2017

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Estonia is subject to the preventive arm of the Pact and should ensure maintaining its fiscal position at the MTO. No country specific recommendations in the area of public finances were addressed to Estonia in the context of the European Semester.

Estonia registered a structural deficit of 0.1% of GDP in 2015, compared with its MTO of a structural balance of 0% of GDP, thus slightly below the medium term objective, but still assessed to be within the margin of tolerance. According to the information provided in the DBP, the recalculated structural balance is estimated to improve to a surplus of 0.5% of GDP in 2016, well above the MTO. This is also confirmed by the Commission forecast. For 2017, the recalculated structural balance is estimated by the DBP to weaken to a deficit of 0.2% of GDP, pointing to some deviation (gap of 0.1% of GDP). The Commission forecast also indicates a structural deficit of 0.2% of GDP for 2017, pointing to some deviation from the MTO (gap of 0.2% of GDP). In 2017, the expenditure benchmark pillar, based on the COM and DBP, points to compliance. The main difference between the structural balance and expenditure benchmark indicator stems from investment expenditure. The weakening of the structural balance in 2017 reflects the above-mentioned postponement of investment from 2016 to 2017, while in the expenditure benchmark calculations nationally financed investment expenditure is smoothed over a medium-term average. In the current case, the smoothed investment profile gives a better indication of the underlying structural position. As mentioned in Section 3.1, the risks to the attainment of the fiscal targets of the DBP are assessed to be balanced. On the basis of this assessment, Estonia is expected to comply with the requirements of the preventive arm of the Pact.

Table 5: Compliance with the requirements of the preventive arm

(% of GDP)	2015	2016		2017	
Initial position[1]					
Medium-term objective (MTO)	0.0	0.0		0.0	
Structural balance[2] (COM)	-0.1	0.6		-0.2	
Structural balance based on freezing (COM)	0.6	0.6		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2015**	**2016**		**2017**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	Compliant			0.0	
Required adjustment corrected[5]				-0.6	
Change in structural balance[6]				-0.7	-0.8
One-year deviation from the required adjustment [7]				-0.1	-0.2
Two-year average deviation from the required adjustment [7]				-0.1	-0.1
Expenditure benchmark pillar					
Applicable reference rate[8]				3.6	
One-year deviation [9]				0.6	0.3
Two-year average deviation [9]				1.8	0.4
Conclusion					
Conclusion over one year				Overall assessment	Overall assessment
Conclusion over two years				Compliance	Compliance

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 27.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) was carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations.

5. IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

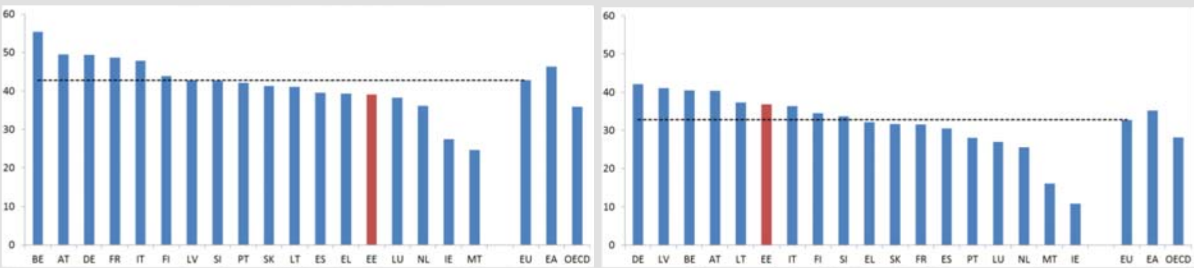
The DBP makes an explicit reference to the structural country-specific recommendations issued by the Council in the context of the 2015 European Semester, notably regarding local government reform and public services at local level, the gender pay gap, and investment in RDI[7]. The DBP gives details on a number of measures that address the recommendations. Most of these measures concern legislative changes and strategic development plans with medium term fiscal implications, some costs also impacting the 2017 budget. A comprehensive assessment of progress made in the implementation of the country-specific recommendations will be made in the 2017 Country Reports and in the context of the country-specific recommendations to be adopted by the Council in 2017.

Box 2: Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker’s net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Estonia for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Estonia at the average wage and a low wage (2015)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.
Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

In the context of the 2016 European Semester, Estonia did not receive recommendations in the area of tax burden on labour, but such a recommendation existed in the previous year. Estonia has taken in 2015 several medium term measures to shift tax burden from labour to consumption and environmental taxes. Notably, the increases in the monthly income tax allowance will continue on

[7] The country specific recommendations directed to Estonia did not include fiscal-structural issues.

average by more than 6% each year (to reach EUR 204 by 2019) and social tax will be reduced by 0.5 pp. in 2017 and 2018. These tax cuts will be financed by increases in other taxes and excises. Overall, these measures would lower the tax wedge both for the average wage earners as well as the low wage earners. Estonia also introduced an income tax refund system for low-wage earners (effective in 2016, but fiscal costs will incur starting from 2017). However, its actual effectiveness to incentivise employment and achieve social aims is reduced by the complexity of the refund system (tax refunds once a year with a long delay, based on meeting certain criteria).

6. Overall conclusion

Estonia was at its medium term objective in 2015 and according to both the information provided in the DBP and the Commission forecast, is expected to be above its MTO in 2016. In 2017, based on both the DBP and the Commission forecast, the structural balance points to some deviation, while the expenditure benchmark points to compliance. On the basis of an overall assessment, it appears that Estonia is expected to comply with the requirements of the preventive arm of the SGP.