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COMMISSION OPINION

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on the Draft Budgetary Plan of ESTONIA

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a draft budgetary plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING ESTONIA

3. On the basis of the Draft Budgetary Plan for 2014 submitted on 15 October 2013 by Estonia, the Commission has adopted the following opinion in accordance with Article 7 of the Regulation (EU) No 473/2013.

4. Estonia is subject to the preventive arm of the SGP and should preserve a sound fiscal position which ensures compliance with the medium-term objective (MTO).

5. The economic projections in the Draft Budgetary Plan are broadly in line with the Commission 2013 Autumn Forecast but forecast higher real GDP growth for 2014 (3.6% versus 3.0%); the difference is less marked for the nominal GDP growth (6.8% versus 6.5% for 2014). The Draft Budgetary Plan forecast for 2013 has been halved compared with the Stability Programme presented in spring 2013, reflecting a worse-than-expected outcome in the first half of 2013. Nevertheless, the Draft Budgetary Plan real GDP growth forecast for 2014 has remained unchanged. However, increasing labour market tensions may result in even higher wage growth than expected in the Commission forecast and thus constitute a downside risk to the macroeconomic scenario in the Draft Budgetary Plan.

6. The macroeconomic forecast underlying the Draft Budgetary Plan was prepared by the Fiscal Policy Department in the Ministry of Finance of Estonia. Although the staff preparing the forecast is part of the Ministry, and no independent body effectively endorsed the forecast, its objectivity benefits from the transparency of the forecasting process, including involving independent forecasters via seminars. As of 2014 it is envisaged that the Bank of Estonia will assume the function of independent fiscal supervisory body (Fiscal Council) and will be responsible inter alia for endorsing the macroeconomic forecasts of the Ministry of Finance of Estonia.

7. The Draft Budgetary Plan projects the general government deficit to widen to 0.6% of GDP in 2013. This would be marginally higher than the 0.5% of GDP targeted in the Stability Programme. The higher-than-targeted deficit would result mainly from the decision in the Draft Budgetary Plan to reduce the dividend distributions from state-owned enterprises in 2013 and to introduce additional dividend distributions for 2014 and 2015. The 2014 deficit target in the Draft Budgetary Plan is set at 0.4% of

GDP, which is weaker than the position of nominal balance targeted in the Stability Programme. This readjustment is due to a number of factors, including a weaker base and postponement of one-off investments from 2013, but also a higher than previously envisaged current expenditure growth in 2014, while revenue-increasing measures are expected to provide a partial offset.

8. The Commission forecasts a slightly smaller headline deficit for 2013 and 2014 (0.4% and 0.1% of GDP, respectively) compared with the target set in the Draft Budgetary Plan, partly due to a smoother public investment projection. Risks to the fiscal target for 2014 seem balanced overall, with some positive risks reflected in the Commission forecast, but with some downside risk to the macroeconomic scenario presented in the Draft Budgetary Plan.

9. The debt-to-GDP ratio will remain close to 10% in 2013-14. Differences in the Draft Budgetary Plan, the Stability Programme and the Commission forecast are minor. Risks related to the debt projections are low with general government deficits close to balance.

10. The measures presented in the Draft Budgetary Plan have a net deficit-increasing effect of 0.4% of GDP in 2013 (reflecting the above-mentioned rescheduling of dividend payments) and a net deficit-decreasing effect of 0.7% of GDP in 2014. The main focus is on revenue measures. Adequate control by the Tax and Customs Board is essential to guarantee that the tax-enhancing measures yield the expected effect.

11. After reaching the MTO in 2012, the (recalculated) structural balance[1] is expected to worsen in 2013 by 0.5 pp. of GDP according to the Draft Budgetary Plan and by 0.4 pp. of GDP according to the Commission's 2013 Autumn Forecast. The growth rate of government expenditure in 2013, net of discretionary measures, is projected to exceed the reference medium-term rate of potential GDP growth of 2.3%, according to the Commission forecast, contributing to a worsening of the structural balance. The excess of expenditure growth over the medium term growth rate of potential GDP is expected to contribute to a deterioration of the structural balance in excess of 0.5 pp. of GDP and is therefore significant.

12. In 2014, the (recalculated) structural balance is reverting to the MTO according to both the Draft Budgetary Plan and the Commission forecast. The growth rate of government expenditure net of discretionary revenue measures is above 0.9%, the lower rate under the expenditure benchmark, and, therefore, is not expected to contribute to an annual structural adjustment towards the MTO by 0.5% of GDP. However, the excess is small and is not expected to undermine the achievement of the MTO in 2014, reflecting the volatility of public investment and falling usage of EU funds after the end of the 2007-13 programming period. Overall, the adjustment path towards the MTO in 2014 seems to be appropriate and compliant with the requirement of the preventive arm of the SGP.

13. Estonia has made some progress in addressing the Council recommendations issued in the context of the 2013 European Semester on a further strengthening of the fiscal framework. The (structural) budget balance rule is expected to be adopted before the end of 2013. However, there is limited progress related to strengthening the binding

[1] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

nature of expenditure ceilings in the medium-term budgetary framework and/or to introducing multi-annual expenditure rules.

14. A specific section of the Draft Budgetary Plan makes explicit reference to every structural country-specific recommendation issued by the Council in the context of the 2013 European Semester, giving details on a number of measures of direct relevance that will be financed in the 2014 budget. A number of measures aim to improve incentives to work and ensure more effective social benefit provision, enhance the quality of the education and training systems, tackle the low energy efficiency of the economy and foster access to quality local services. Finally, although not highlighted specifically in the Draft Budgetary Plan, the planned limitations on VAT exemptions for company cars are expected to help address somewhat the Council recommendation aimed to improve energy efficiency in transport and strengthen environmental incentives concerning vehicles.

15. Overall, based on the 2013 Autumn Forecast, the Commission is of the opinion that the Draft Budgetary Plan of Estonia sent on 15 October is compliant with the rules of the SGP. In particular, as confirmed by the Commission 2013 Autumn Forecast, Estonia is expected to remain at its medium-term objective. The Commission is also of the opinion that Estonia has made some progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the European Semester and invites the authorities to make further progress.

Done at Brussels, 15.11.2013

For the Commission
Olli REHN
Vice-President