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Recommendation for a

COUNCIL RECOMMENDATION

on Estonia's 2014 national reform programme

and delivering a Council opinion on Estonia's 2014 stability programme

{SWD(2014) 407 final}

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the resolutions of the European Parliament[3],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States, which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full

[1] OJ L 209, 2.8.1997, p. 1.
[2] COM(2014) 407 final.
[3] P7_TA(2014)0128 and P7_TA(2014)0129.

commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

(4) On 9 July 2013, the Council adopted a recommendation on Estonia's national reform programme for 2013 and delivered its opinion on Estonia's updated stability programme for 2012-2017. On 15 November 2013, in line with Regulation (EU) No 473/2013[4], the Commission presented its opinion on Estonia's draft budgetary plan for 2014[5].

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey[6], marking the start of the 2014 European Semester of economic policy coordination. On the same day on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[7], in which it did not identify Estonia as one of the Member States for which an in-depth review would be carried out.

(6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 8 May 2014, Estonia submitted its 2014 national reform programme and on 29 April 2014 its 2014 stability programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(8) The objective of the budgetary strategy outlined in the 2014 Stability Programme is to be at the medium-term objective and to build sufficient fiscal buffers for difficult economic times. The programme confirms the previous medium-term objective of a structural surplus, which is more stringent than what the Stability and Growth Pact requires. Estonia's recalculated structural balance is expected to worsen by 0.1 pp. of GDP in 2014, thereby deviating from the required adjustment path, before improving by 0.4 pp. of GDP in 2015, and remaining close to balance in 2016-2017. Furthermore, the programme points to a risk of deviation from the expenditure benchmark in 2014 and to a risk of a significant deviation in 2015. Overall, the planned adjustment path towards the medium-term objective presents risks with respect to compliance with the requirements of the Stability and Growth Pact. The macroeconomic scenario underpinning the fiscal projections in the programme, which has not been endorsed by an independent entity, is plausible and broadly in line with the Commission 2014 Spring Forecast. According to the Commission Forecast, the structural deficit is projected to deteriorate by 0.1% of GDP in 2014, leading to a 0.3% of GDP gap compared to the required adjustment and a significant deviation when assessed over two years. In 2015 the Commission foresees another 0.2% of GDP deterioration in the structural balance pointing to significant deviation from the required adjustment toward the medium-term objective. A significant deviation is expected also with respect to the expenditure benchmark over 2014-2015. Based on the assessment of the 2014 Stability Programme and the Commission Forecast, pursuant to Regulation (EC) No 1466/97, the Council is of the opinion that there is a risk of significant deviation from the medium-term objective in 2014 and

[4] OJ L 140, 27.5.2013, p.11.
[5] C(2013) 8002 final
[6] COM(2013) 800 final.
[7] COM(2013) 790 final.

2015. The structural balance rule to comply with the Treaty on Stability, Coordination and Governance entered into force through Estonia's new State Budget Act on 23 March 2014, but the rule is still to be complemented by a strengthening of the binding nature of the multiannual expenditure targets.

(9) As regards the labour market, substantial progress has been made in reducing youth and long-term unemployment. Particular attention needs to be paid to measures that provide incentives to work for low-wage earners. Further efforts are necessary to address growing work-force shortages, including those caused by ageing and health- and disability related exits from the labour market. The timely adoption and implementation of the Work Capacity Reform, while ensuring the availability of enabling services, is therefore highly relevant. The cost-effectiveness of the family policy expenditure could be further improved, including by reallocating financing from parental benefit to measures such as childcare services. This is expected to foster an early return of women to the labour market and to reduce the persistently high gender pay gap. Efforts to promote entrepreneurship and job creation in regions outside Tallinn and Tartu need to be stepped up to prevent economic development differentials from widening and to reduce unemployment, especially among the low-skilled.

(10) In the field of education and training reforms to align education to the requirements of the labour market have recently been adopted. Further efforts will be necessary to facilitate the transition from education to employment. Systematic efforts will be needed, in particular involving social partners, to increase participation in vocational education and training, and in work-based learning, especially apprenticeships. The implementation of the Lifelong Learning Strategy will require serious efforts to provide the much-needed up-skilling, re-skilling and qualification levels, especially for people in a weak position vis-à-vis the labour market. There is a smart specialisation framework that comprises the Entrepreneurship and Growth Strategy and the Research, Development and Innovation Strategy with a focus on shared priorities while further specialising the thematic areas. Efforts should continue towards the internationalisation and prioritisation of the research and development and innovation system, given the small size of the economy.

(11) Estonia's resource intensity continues to be very high. There has been progress in addressing the energy efficiency of public buildings, but efforts need to be sustained and increased, notably in the residential and industrial sectors. Substantial progress has been made with respect to waste management and landfilling, while the economic viability of recycling needs to be ensured. Measures in the Transport Development Plan need to be implemented to notably enable Estonia to contain CO2 emissions in the non-ETS sector. The energy efficiency of freight transport can be improved by deploying more sustainable modes of transport. The use of public transport can be further increased through enhancing the complementarity of regional networks and interconnections between coach and passenger rail transport. The use of private cars increases, while the average age of the passenger car fleet is almost double the EU average and new passenger cars are among the most pollutant in the EU. Substantial strengthening of environmental incentives, including taxation, is necessary. While promising steps have been taken in cross-border energy connections, full linking up of Estonia's energy market to the EU will require time and investment.

(12) Widening regional differences combined with negative demographic trends, inefficiencies and lack of cooperation among local governments hamper Estonia's

development potential. . This partly reflects the persistent mismatch between fiscal capacity and devolved responsibilities in small municipalities as well as limited economies of scale. A more efficient and accessible delivery of quality public services at local level, based on service areas and minimum service standards, especially in transport, long-term care, early childhood education and social services, is a prerequisite for activation and labour market measures to be effective.

(13) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Estonia's economic policy. It has assessed the stability programme and the national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Estonia but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (5) below.

(14) In the light of this assessment, the Council has examined Estonia's stability programme, and its opinion[8] is reflected in particular in recommendation (1) below.

(15) In the context of the European Semester the Commission has also carried out an analysis of the economic policy of the euro area as a whole. On the basis of this analysis, the Council has issued specific recommendations for the Member States whose currency is the euro. Estonia should also ensure the full and timely implementation of these recommendations.

HEREBY RECOMMENDS that Estonia take action within the period 2014-2015 to:

1. Reinforce the budgetary measures for 2014 in the light of the emerging gap of 0.3% of GDP based on the Commission 2014 spring forecast, pointing to a risk of significant deviation relative to the Stability and Growth Pact requirements. In 2015, significantly strengthen the budgetary strategy to ensure reaching the medium-term objective and remain at it thereafter. Complement the budget rule with more binding multi-annual expenditure rules within the medium-term budgetary framework and continue to enhance the efficiency of public spending.

2. Improve incentives to work through measures targeted at low income earners. Target activation efforts at those most distant from the labour market, in particular by ensuring the timely adoption and implementation of the work capacity reform. Increase the efficiency and cost-effectiveness of family policy while improving the availability and accessibility of childcare. Deploy coordinated measures for fostering economic development and entrepreneurship in regions faced with high unemployment.

3. To ensure the labour-market relevance of education and training systems, improve skills' and qualification levels by expanding life-long learning measures and systematically increasing participation in vocational education and training, including in apprenticeships. Further intensify prioritisation and specialisation in the research and innovation systems and enhance cooperation between businesses, higher education and research institutions to contribute to international competitiveness.

4. Step up efforts to improve energy efficiency, in particular in residential and industrial buildings. Substantially strengthen environmental incentives for the transport sector

[8] Under Article 5(2) of Council Regulation (EC) No 1466/97.

to contribute to less resource-intensive mobility. Continue the development of cross-border connections to neighbouring Member States to diversify energy sources and promote competition through improved integration of the Baltic energy markets.

5. Better balance local government revenue against devolved responsibilities. Improve the efficiency of local governments and ensure the provision of quality public services at local level, especially social services complementing activation measures.

Done at Brussels,

For the Council
The President