Eurogroup

**Brussels, 24 November 2014**
**(OR. en)**

**EG 17/1/14**
**REV 1 ADD 1**

**ECOFIN 1018**
**UEM 360**
**EUROGROUP 25**

**COVER NOTE**

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| From: | Martin Poder, Financial Counsellor, Permanent Representation of the Republic of Estonia to the European Union |
| date of receipt: | 24 November 2014 |
| To: | Mr Carsten PILLATH, Director General, Council of the European Union |
| Subject: | Estonia:<br>Draft Budgetary Plan of Estonia for 2015, as laid down in Article 6(1) of Reg. (EU) 473/2013 on Common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the member states in the euro area |

Delegations will find attached the revised version of Estonia's Draft Budgetary Plan for 2015 in English.

This document is aimed for discussion in the **Eurogroup**.

RAHANDUS-
MINISTEERIUM

MINISTRY of FINANCE of the REPUBLIC of ESTONIA

# Estonian 2015 Draft Budgetary Plan

Tallinn, 15 October 2014

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# Introduction

According to the European Parliament and Council Regulation (EU) No 473/2013 entered into force on 30 May 2013 about the common rules of monitoring and evaluation of Member States budget plans and ensuring the correction of their excessive deficit (EU OJ L 140, 27.05.2013) all euro area Member States must submit next year's draft budgetary plans (DBP) by 15 October.

Preparation and assessment of budgetary plans in autumn is an additional step in a framework of coordinated surveillance, which already included presenting and assessing the Stability Programmes by the Council and the Commission in spring. This contributes to coordination of policies in between the euro area countries and ensures that the recommendations of the Council and of the Commission are taken into account accordingly in the budget processes of the member states.

The information provided in DBP should allow to identify possible discrepancies of budget strategy in the last Stability Program.

State Budget Strategy with Stability Program was approved by the Government on 29 April 2014. **The draft 2015 State Budget with explanatory memorandum was approved on 23 September in the meeting of the Government and was given for proceeding to Parliament on 24 September.**

The draft 2015 State Budget of the Republic of Estonia is based on State Budget Strategy 2015–2018, The Government's Action Program and The European Commission and the Council recommendations[1] (given according to Stability Program and Estonian 2020 Competitiveness plan) and designed activities according to these. Budgetary policy formulation respects the Stability and Growth Pact requirements of the EU Member States budgetary policy.

**In compliance with State Budget Strategy the structurally adjusted budgetary position of general government will be in surplus (0.8% of forecasted GDP) in 2015. Thus Estonia holds its MTO set in 2007 – the structural surplus.**

[1] Estonia's country-specific recommendations shortly:
(1) Maintaining sound budgetary condition.
(2) Changing social benefit system more effective and stimulating employment.
(3) Better binding of education with the needs of labor market.
(4) Increasing saving energy and resources.
(5) Improving efficiency of local authorities in providing services.
Activities to comply with the recommendations of European Commission are Publisher annually http://valitsus.ee/et/riigikantselei/eesti2020.

# 1. Macroeconomic forecast

The Draft of State Budget 2015 of the Republic of Estonia is based on the summer forecast of the Ministry of Finance, published on 1 September 2014. Economic forecasts of the Ministry of Finance are public and can be found from the web page of the ministry (http://www.fin.ee/economic-policy).

Foreign assumptions of current forecast are fixed as from the end of July 2014. However, the impact of Russian import ban to certain food products since August is taken into account in the main scenario as well, because of its apparent impact on Estonian economy (look at Annex 2). According to estimations, direct impact of current embargo will be restrained and the main scenario of the forecast is counting its broader impact to the extent that this ban is expressed in those countries own economic forecasts. As the events of last month's have not reached to public economic forecasts, then the negative scenario of the forecast will consider the further deterioration of Estonian export markets.

After the previous forecast by the Ministry of Finance, published in spring 2014, economic sentiment in the EU has improved but at a decreasing pace. Assessment of the global economic situation is also more positive than six or twelve months ago. Estonian export partners' growth expectations have nevertheless been decreased, which keeps foreign demand for our products still depressed. Estonian economic sentiment has been weakening during the past six months due to low performance in the services sector (mainly transportation and storage) and construction, where confidence has been on a declining trend for the past two years. Confidence in manufacturing is low but stable and mostly dependent on developments in the external environment, which is dependent on economic policies in the EU and euro area and the geopolitical conflict related to Russia. Confidence in trade has been high and stable due to confident consumers, whose purchasing power has been growing fast during the past year. The continuation of fast wage growth is dependent on improving foreign conditions, which has experienced a setback during the recent months.

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According to the main scenario **Estonian GDP** will grow by 0.5 in 2014 and 2.5% in 2015. By 2016, we expect growth to pick up to 3.5%. Ministry of Finance has cut the GDP forecast of this year compared to the spring forecast mainly due to weak growth rate of the first half of the year and also weaker growth outlook of the main trading partners. This year GDP growth will be supported primarily by the increase of domestic demand, but exports' growth will pick up in the second half of this year. Growth of imports will be faster compared to exports and therefore the contribution of net exports will increase. 2015 and 2016 growth forecasts have also been revised downwards compared to the previous forecast. 2015 and the two following years we expect export growth to pick up, but also the support of domestic demand remains strong, which is why net exports to GDP growth will remain negative.

The relatively fast pace of growth in **private consumption** will slow down somewhat, to 3.6% this year. The growth rate will remain fast, regardless of the wage growth slowing down. Consumer confidence has remained high, supported by a decrease of unemployment. Slower inflation helps retain the purchasing power of incomes. In 2015, net incomes will also increase due to a lowered income tax rate and slashed unemployment insurance payments, enabling 3.8% growth of private consumption. Similar to last year, the level of **investments** will remain moderate this year and may even turn to a decline. Investments of companies are still held back by a low demand for their products and a decrease of government projects funded from the sales revenues of CO2 allowances. Household investments in residential property are slowly growing and support the construction market. The expected improvement of foreign demand should lead corporate investments to a growth path again in 2015.

**Exports** of goods and services will grow by 2.0% in 2014. The growth is driven by strong services exports. Furthermore, favored by weak comparison basis, the increase in goods exports can be expected in the second half of 2014. Foreign demand will start to pick up in 2015 and the growth opportunities of manufacturing companies will be expanded by a gradual recovery of Finnish economy as well. Growth of exports will pick up at the similar pace like foreign demand, reaching 3.5% in 2015 and stabilizing in the end of the forecast horizon at 6%. Imports of goods and services will accelerate as a result of relatively high import content of exports and stronger domestic demand. During the forecast period growth of imports will be somewhat faster compared to exports due to high investments needs of companies and continuous wage increases, resulting in growing imports of capital and consumer goods.

**Current account** deficit will increase to 2.3% of GDP in 2014 as a result of reserved export performance and stronger domestic demand. During the forecast period foreign balance will worsen somewhat because of increasing investment activity. Balance of services will improve slightly this year, but will remain stable afterwards. Current transfers will be influenced largely by contributions from EU funds, surplus of current transfers will remain around 1% of GDP in coming years.

Consumer price **inflation** (CPI) will reach 0.3% in 2014, then accelerating to 1.9% in 2015 and to 2.5% in 2016. Inflation will pick up gradually in autumn due to slowdown of energy price decrease and slightly growing food prices as a result of low price level of fruits and vegetables a year ago. During 2015–2016 administrative prices will push the inflation as well, from which excise duty increases of alcohol and tobacco constitute the biggest part. Core inflation will start to pick up in line with the price pressures from higher wage increases, growing prices of imported industrial goods and a slowdown of declining communication service prices. In addition, growing food prices in foreign markets will start to affect the inflation in coming years. In the end of forecast period inflation will reach 3% as a result of increasing contribution of foreign factors, administrative measures and stronger increases of service prices.

**Employment** growth has stopped and is forecasted to start to decline from 2016 on. The slight increase in employment, which was forecasted in spring, will probably not materialize because of lower economic activity. So far employment has increased despite the decline of working age population in aggregate, which has taken place already from the beginning of the century, because of the increase in employment and participation rates. These trends cannot continue much longer and thus the decrease of employment will start to restrict economic growth starting from 2016. The unemployment rate will decline close to 6% by the end of the forecasting horizon under favourable economic conditions.

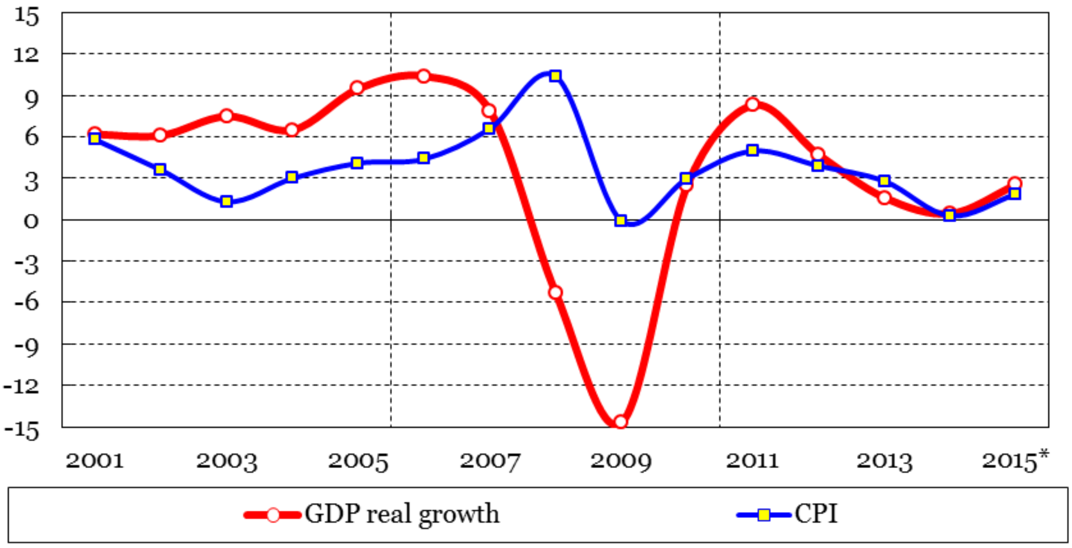
**Average wage** growth decelerates to 6% in 2014 and should stay close to that rate during the following years. Recovery of demand and export partners' nominal growth may even accelerate nominal wage growth somewhat, but real wage growth should get more in line with productivity growth. Rapid real wage growth, which has been supported by declining import prices, will in the future be more dependent on productive investment. Wage bill growth has exceeded nominal GDP growth starting from 2013, but these growth rates should get more equal in the near future.

On the 8th of September Statistics Estonia published new GDP time series based on revised data sources and the new national accounts standard ESA2010. The summer forecast of the Ministry of Finance was published before that date and was thus based on previous time series. This forecast contains some technical corrections to the summer forecast, in order to make it compatible with the new time series.

## Figure 1

### Estonian economic growth and the change of consumer price index

*(per cent)*

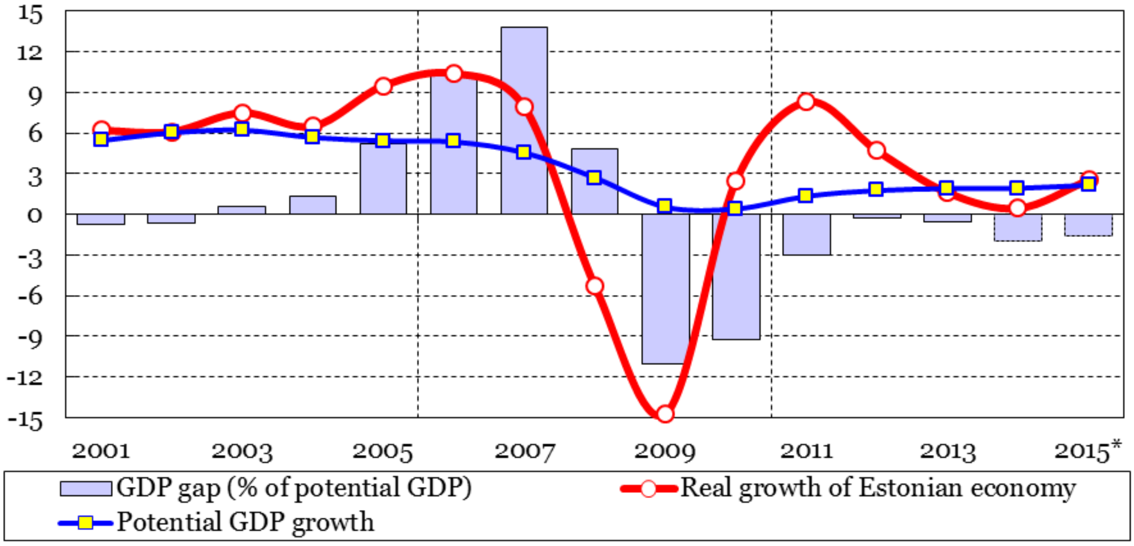



*Source: Statistics Estonia, Ministry of Finance.*

## Figure 2

**Development of potential GDP and output gap**

*(per cent)*




*Source: Statistics Estonia, Ministry of Finance.*

## Table 0.i) Basic assumptions

| | 2013 | 2014* | 2015* |
|---|---|---|---|
| **Short-term interest rate[1] (annual average)** | 0.2 | 0.3 | 0.3 |
| **Long-term interest rate (annual average)** | 1.6 | 1.6 | 1.9 |
| **USD/€ exchange rate (annual average)** | 0.753 | 0.744 | 0.744 |
| **Nominal effective exchange rate** | 1.4 | 0.4 | 0.0 |
| **World excluding EU, GDP growth** | 3.6 | 3.9 | 4.2 |
| **EU GDP growth** | 0.1 | 1.4 | 1.7 |
| **Growth of relevant foreign markets** | 0.9 | 1.3 | 1.8 |
| **World import volumes, excluding EU** | 3.1 | 4.5 | 5.7 |
| **Oil prices (Brent, USD/barrel)** | 108.5 | 108.5 | 106.3 |

*Source: Ministry of Finance.*

## Table 1.a. Macroeconomic prospects

| | ESA code | 2013 Level | 2013 rate of change | 2014* rate of change | 2015* rate of change |
|---|---|---|---|---|---|
| **1. Real GDP** | B1*g | 16,936.9 | 1.6 | 0.5 → 1.5 (1/) | 2.5 |
| of which | | | | | |
| 1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth[1] | | – | – | – | – |
| **2. Potential GDP** | | | 1.9 | 1.9 | 2.2 |
| contributions: | | | | | |
| - labour | | | 0.1 | 0.0 | -0.1 |
| - capital | | | 1.6 | 1.5 | 1.5 |
| - total factor productivity | | | 0.2 | 0.5 | 0.7 |
| **3. Nominal GDP** | B1*g | 18,738.8 | 6.2 | 3.0 | 5.8 |
| **Components of real GDP** | | | | | |
| **4. Private final consumption expenditure** | P.3 | 8,354.2 | 3.8 | 3.6 | 3.8 |
| **5. Government final consumption expenditure** | P.3 | 3,190.5 | 2.8 | 1.0 | 1.0 |
| **6. Gross fixed capital formation** | P.51 | 4,704.7 | 2.5 | 5.2 | 5.5 |
| **7. Changes in inventories and net acquisition of valuables (% of GDP)** | P.52 + P.53 | -89.3 | -0.5 | 1.8 | 1.7 |
| **8. Exports of goods and services** | P.6 | 14,999.5 | 2.6 | 2.0 | 3.5 |
| **9. Imports of goods and services** | P.7 | 14,842.9 | 3.1 | 3.9 | 4.3 |
| **Contributions to real GDP growth** | | | | | |
| **10. Final domestic demand** | | | 3.1 | 2.0 | 3.5 |
| **11. Changes in inventories and net acquisition of valuables** | P.52 + P.53 | | -2.2 | 0.1 | -0.3 |
| **12. External balance of goods and services** | B.11 | | -0.5 | -1.7 | -0.7 |

1/ In summer forecast of the Ministry of Finance, based on previous national accounts statistics, 0.5% GDP growth and 2.6% GDP deflator for 2014 was expected. However, during the revision of time series real growth of first half of 2014 was revised upwards and deflator downwards, nominal growth rate remained similar. Therefore, current forecast has been technically adjusted for being comparable to the historical time series (primarily nominal levels, for 2014 real GDP growth and deflator as well).
2/ Implementation of budgetary measures were decided after the completion of macroeconomic forecast and therefore their impact on economic growth is not included in the forecast.

*Source: Statistics Estonia, Ministry of Finance.*

## Table 1.b. Price developments

| | ESA code | 2013 *level 2010=100* | 2013 rate of change | 2014* rate of change | 2015* rate of change |
|---|---|---|---|---|---|
| **1. GDP deflator** | | 110.6 | 4.5 | 2.6 → 1.6 (1/) | 3.1 |
| **2. Private consumption deflator** | | 112.2 | 3.1 | 1.0 | 2.3 |
| 3. HICP | | 113.1 | 3.2 | 0.8 | 2.3 |
| 4. Public consumption deflator | | 112.2 | 5.8 | 4.6 | 4.5 |
| 5. Investment deflator | | 108.8 | 4.9 | 2.8 | 2.3 |
| **6. Export price deflator (goods and services)** | | 107.5 | 1.0 | -0.2 | 1.0 |
| **7. Import price deflator (goods and services)** | | 107.6 | -0.4 | -0.5 | 0.8 |

1/ In summer forecast of the Ministry of Finance, based on previous national accounts statistics, 0.5% GDP growth and 2.6% GDP deflator for 2014 was expected. However, during the revision of time series real growth of first half of 2014 was revised upwards and deflator downwards, nominal growth rate remained similar. Therefore, current forecast has been technically adjusted for being comparable to the historical time series (primarily nominal levels, for 2014 real GDP growth and deflator as well).

*Source: Statistics Estonia, Ministry of Finance.*

## Table 1.c. Labour market developments

| | ESA code | 2013 *Level* | 2013 *rate of change* | 2014* *rate of change* | 2015* *rate of change* |
|---|---|---|---|---|---|
| **1. Employment, persons** | | 621.4 | 1.0 | 0.1 | 0.0 |
| 2. Employment, hours worked | | | | | |
| **3. Unemployment rate (%)** | | 58.7 | 8.6 | 7.5 | 6.8 |
| **4. Labour productivity, (real GDP per employed person)** | | 27,258 | 0.6 | 0.9 | 2.5 |
| 5. Labour productivity, hours worked | | | | | |
| **6. Compensation of employees** | D.1 | 8,708.7 | 8.2 | 6.8 | 6.6 |
| **7. Compensation per employee** | | 14,014 | 7.8 | 6.0 | 6.1 |

*Source: Statistics Estonia, Ministry of Finance.*

## Table 1.d. Sectoral balances

| | ESA code | 2013 *% of GDP* | 2014* *% of GDP* | 2015* *% of GDP* |
|---|---|---|---|---|
| **1. Net lending/net borrowing vis-à-vis the rest of the world** | B.9 | 1.4 | 0.4 | 0.3 |
| *of which*: | | | | |
| - balance on goods and services | | 1.3 | 0.2 | -0.3 |
| - balance of primary incomes and secondary incomes | | -2.6 | -2.5 | -2.4 |
| - capital account | | 2.8 | 2.7 | 3.0 |
| 2. Net lending/net borrowing of the private sector | B.9 | | | |
| 3. Net lending/net borrowing of general government | B.9 | -0.5 | -0.3 | -0.5 |
| **4. Statistical discrepancy** | | 0.0 | – | – |

*Source: Statistics Estonia, Ministry of Finance.*

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Economic forecast of the Ministry of Finance is prepared by analysts from Fiscal Policy Department, who belong to personnel of the Ministry. The objectivity and independence of the forecast is assured through the transparency of forecast process, involvement of different outdoor economists and through continuous comparison of forecasting results. The preliminary version of forecast will be discussed with the forecasting team of Bank of Estonia. Before the finalisation of the forecast of Ministry of Finance, its main assumptions and results will be discussed in joint seminar with different forecasters of Estonia, who belong to central bank, commercial banks and other institutions dealing with economic analysis. There are approximately 10 institutions taking part from this seminar. In addition, different comparative tables and figures with the outcome of different independent forecasters can be found from the document of Ministry's economic forecast. On the basis of this it is easy to be convinced of systematical inducement by some forecasters.

Changes to the framework of co-ordination of economic and fiscal policies of EU Member States provide the creation of independent fiscal councils in all euro area countries, which monitor the accordance of fiscal policy to fiscal rules and assess the need to use the correction mechanisms implemented in the framework. Estonian Fiscal Council was created attached to the Central Bank in 2014. According to the founding act of the Fiscal Council, it must provide the assessment of government's economic and fiscal forecast, medium-term budget strategy and of achievement of objective in terms of structural budget balance.

The opinion of Fiscal Council on summer 2014 economic forecast of the Ministry of Finance on 15.09.2014 says:[2]

- „The Fiscal Council finds that the new macro forecast of the Ministry of Finance is an appropriate basis to use for both nominal and real economic growth and for tax revenues in the draft state budget for next year."
- „The Fiscal Council recommends that the government … produce a state budget where the general government structural surplus is no smaller than the 0.8% of GDP put forward in the summer forecast. In this case there is greater certainty that the state budget for 2015 will comply with the law and will suit the targets set in the state budget strategy for 2015–2018."

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In the following, there are pointed out most relevant differences between Ministry of Finance's 2014 summer forecast and other institutions latest public macroeconomic forecasts. Comparing them, one should keep in mind that forecasts are compiled in different periods and therefore based on different information, which causes variations in assumptions and results of the forecasts. As the foreign environment is uncertain and future prospects are differing from prior, then one should consider the assumptions of that time while estimating earlier forecasts.

While in the beginning of the year forecasters expected 2014 economic growth to reach 2–3%, then after the negative growth rate of 1st quarter and deepening the Ukrainian crisis, Estonian growth forecasts were cut. Forecasts published during summer remained above 0.5%. Ministry of Finance's summer forecast for 2014 is conservative, staying below of the range of GDP growth expectations.

For 2015, institutions expect pickup in economic growth, however the variability of forecasts is quite large. Forecasts published in summer expect 2–4% economic growth, depending on the recovery of Estonian export markets and the speed of receding of geopolitical tensions. Ministry of Finance's expectations for 2015 are comparable to the latest forecasts of other institutions.

[2] More detailed analysis is found on the web page of the Fiscal Council: http://eelarvenoukogu.ee/files/FC_opinion_18092014.pdf.

## Table 1.e. Comparison of economic forecasts

| | Real GDP growth, % | | | Nominal GDP growth, % | | |
|---|---|---|---|---|---|---|
| | 2014* | 2015* | 2016* | 2014* | 2015* | 2016* |
| **Ministry of Finance** | **0.5** | **2.5** | **3.5** | **3.0** | **5.8** | **6.6** |
| European Commission | 1.9 | 3.0 | – | 4.7 | 6.5 | – |
| Bank of Estonia | 0.7 | 3.9 | 3.6 | 4.1** | 6.6** | 6.6** |
| IMF | 2.4 | 3.2 | – | – | – | – |
| OECD | 1.2 | 3.1 | – | 3.2 | 5.2 | – |
| SEB | 0.5 | 1.8 | 3.0 | – | – | – |
| Swedbank | 0.8 | 2.3 | 3.0 | 3.9 | 5.7 | 6.3 |
| Nordea | 1.2 | 3.2 | – | 2.7** | 7.4** | – |
| Consensus Forecasts | 0.8 | 2.6 | – | – | – | – |
| Estonian Institute of Economic Research | 2.7 | – | – | – | – | – |

| | Consumer price index, % (in brackets Harmonised Consumer Price Index) | | | General government position, % of GDP | | |
|---|---|---|---|---|---|---|
| | 2014* | 2015* | 2016* | 2014* | 2015* | 2016* |
| **Ministry of Finance** | **0.3 (0.8*)** | **1.9 (2.3*)** | **2.5 (2.8*)** | **-0.2** | **-0.5** | **0.0** |
| European Commission | 1.5* | 3.0* | – | -0.5 | -0.6 | – |
| Bank of Estonia | 0.8 (1.3*) | 2.4 (2.8*) | 2.7 (3.0*) | -0.6 | -0.8 | -0.3 |
| IMF | 3.2* | 2.8* | – | – | – | – |
| OECD | 0.7* | 1.7* | – | -0.2 | -0.1 | – |
| SEB | 0.1 | 1.6 | 1.9 | – | – | – |
| Swedbank | 0.3 | 2.5 | 2.7 | -0.5 | -0.4 | -0.2 |
| Nordea | 1.0 | 2.6 | – | -1.1 | -0.9 | – |
| Consensus Forecasts | 0.9 | 2.3 | – | – | – | – |
| Estonian Institute of Economic Research | 2.2 | – | – | – | – | – |

** calculated from the forecast of nominal GDP volume.

*Sources:*
*Ministry of Finance Economic Forecast. Summer 2014. 1.09.2014.*
*European Commission. Economic Forecast. Spring 2014. 5.05.2014.*
*IMF. World Economic Outlook. April 2014. 8.04.2014.*
*OECD Economic Outlook. No 95. May 2014, 6.05.2014.*
*Bank of Estonia. Monetary policy and economy. 1/2014. 11.06.2014.*
*Estonian Institute of Economic Research. Konjunktuur No 3 (188) 2014. 7.04.2014.*
*SEB. Nordic Outlook. August 2014. 26.08.2014.*
*Swedbank. Swedbank Economic Forecast. 26.08.2014.*
*Nordea. Estonian Outlook. 11.06.2014.*
*Eastern Europe Consensus Forecasts. 18.08.2014.*

# 2. Budgetary targets

**The Governments medium-term objective (MTO) is the general government structural surplus.** Since 2009, after the global economic crisis the budgetary position of general government has been in structural surplus and the MTO is therefore met.

In 2014 the structurally adjusted budgetary position of general government improves due to economic cycle to 0.9% of GDP. The general goal of fiscal policy is to preserve neutral or countercyclical budget policy, however, until the correction of the nominal deficit incurred during the crisis, the government intends to implement fiscal policy stricter than economic cycle requires. For coming years the structurally adjusted budgetary position will remain in surplus. **In 2015, the structurally adjusted budgetary position of general government will be in surplus 0.8% of GDP, which exceeds targeted outcome set by State Budget Strategy by 0.6% of GDP.** Structural surplus indicates that there are no sustainability problems in state budget and the next year's nominal deficit is caused by temporary factors. **Thus Estonia holds its MTO set in 2007 – the structural surplus.**

In 2013, the budgetary deficit of the general government increased to 89 million Euros or 0.5% of GDP. The central government and local governments ended the year with a deficit of 0.3% and 0.5% of GDP respectively; social security funds were in a surplus of 0.3% of GDP. The deficit was worsened despite of better than forecasted tax receipts, primarily in the part of corporate income tax. Local governments were in more than double the expected deficit, caused primarily by an increase of investments, related inter alia to last autumn's local elections.

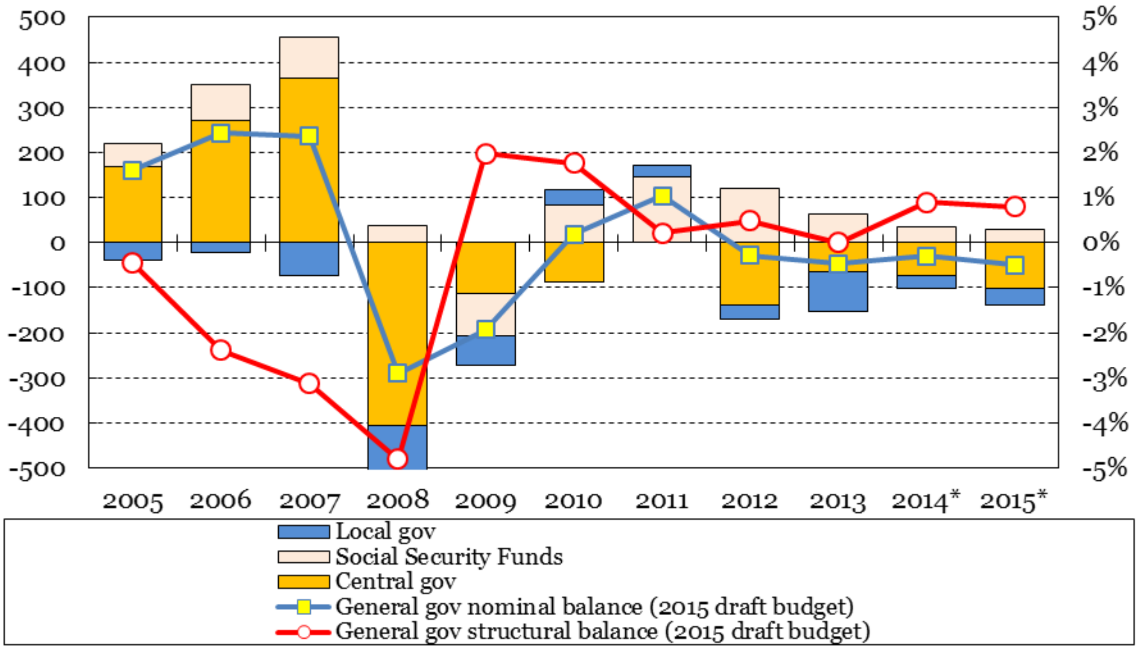
According to the forecast in draft State Budget of 2015, the nominal budget deficit in 2014 will amount to 0.3% of GDP. The deficit is attributed mainly to the central government, but also the local governments will be in deficit according to forecast. Social security funds are continually in surplus of 0.2% of GDP due to Unemployment Insurance Fund. For 2015 the draft budget foresees the general government nominal deficit of 0.5% of GDP.

In 2013 general government debt increased from 9.7% to 10.1% of GDP, amounting to 1 888 million Euros. The main reasons for the government debt increasing were an increase in loans issued by the European Financial Stability Fund (EFSF) and the increase of debt of local governments. The general government debt can be expected to increase to 10.1% of GDP in 2013 as a result of the EFSF's activities, in 2014 debt will decrease to 10% of GDP. As according to the forecast there is no need to take new loans both the current as well as next year, the debt burden is reduced by the end of 2015 to 9.3% of GDP

## Figure 3

### General government budgetary position

*(% of GDP)*

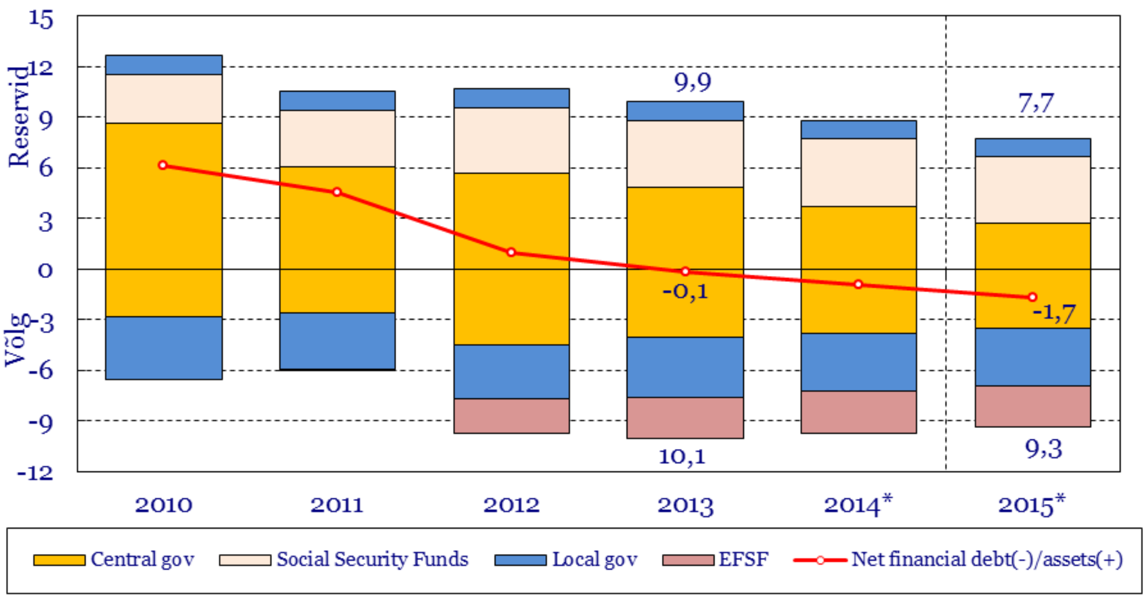



*Source: Statistics Estonia, Ministry of Finance.*

## Figure 4

### General government liquid financial assets, gross debt and net financial debt

*(% of GDP)*

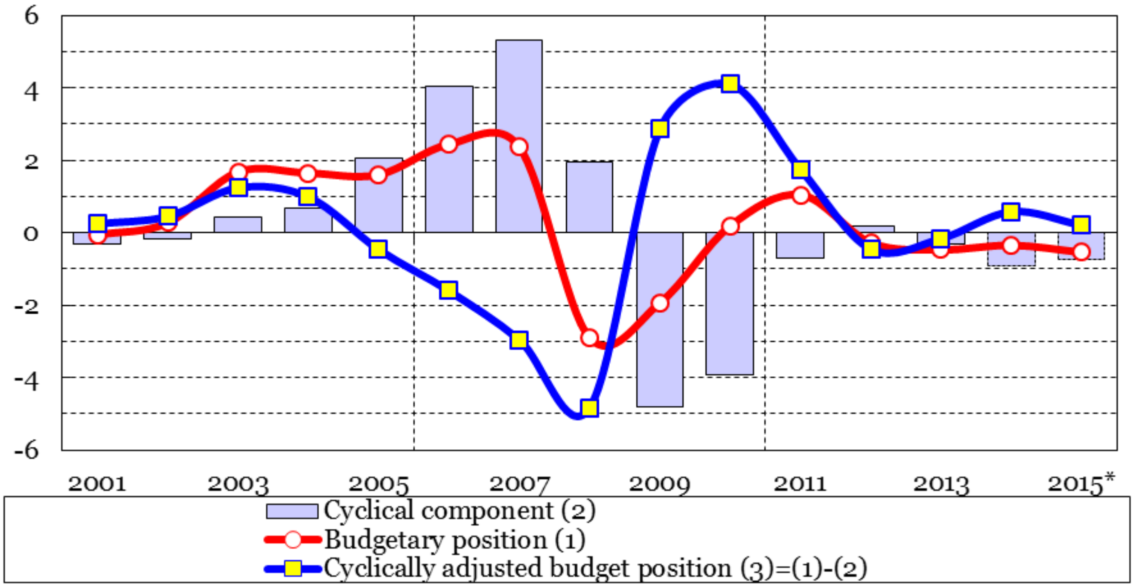



*Source: Statistics Estonia, Ministry of Finance.*

## Figure 5

### General government cyclically adjusted budgetary position

*(% of GDP)*

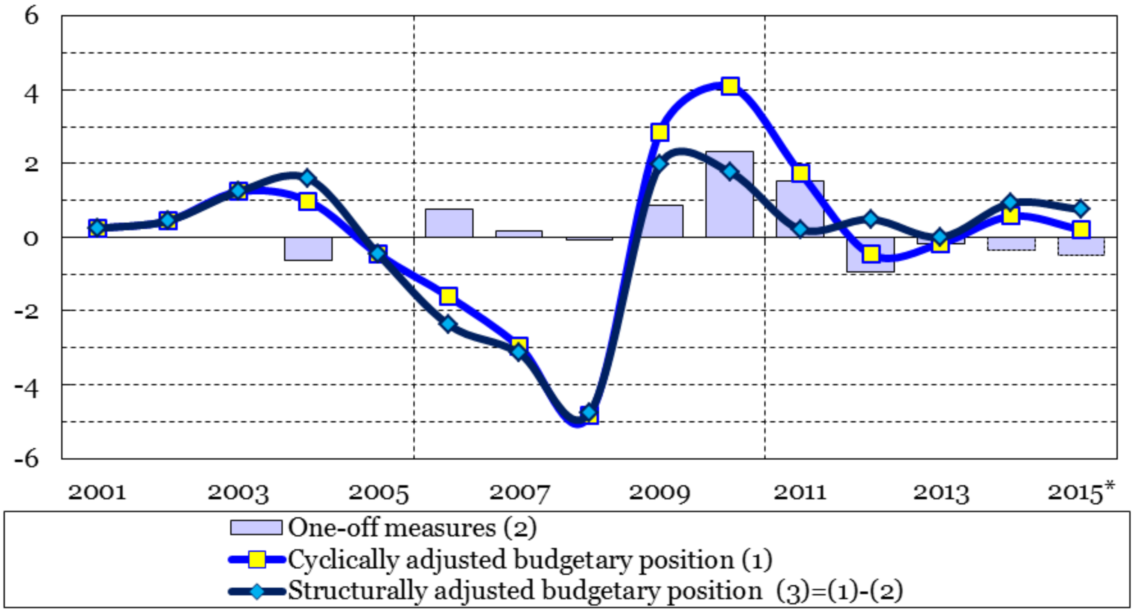



*Source: Statistics Estonia, Ministry of Finance.*

## Figure 6

### General government structurally adjusted budgetary position

*(% of GDP)*




*Source: Ministry of Finance.*

## Table 2.a. Budgetary position objective of the general government by sub-sector

| | ESA Code | 2014 (1/) | 2015* |
|---|---|---|---|
| | | % of GDP | % of GDP |
| **Net lending (+) / net borrowing (-) ( B.9) by sub-sector** | | | |
| **1. General government** | S.13 | -0.3 | -0.5 |
| **2. Central government** | S.1311 | -0.4 | -0.4 |
| **3. State government** | S.1312 | – | – |
| **4. Local government** | S.1313 | -0.2 | -0.2 |
| **5. Social security funds** | S.1314 | 0.2 | 0.2 |
| **6. Interest expenditure** | D.41 | 0.1 | 0.2 |
| **7. Primary balance[3]** | | -0.2 | -0.4 |
| **8. One-off and other temporary measures[4]** | | -0.4 | -0.5 |
| **9. Real GDP growth (%) (=1. in Table 1a)** | | 1.5 | 2.5 |
| **10. Potential GDP growth (%) (=2 in Table 1.a)** | | 1.9 | 2.2 |
| contributions: | | | |
| - labour | | 0.0 | -0.1 |
| - capital | | 1.5 | 1.5 |
| - total factor productivity | | 0.5 | 0.7 |
| **11. Output gap (% of potential GDP)** | | -2.1 | -1.7 |
| **12. Cyclical budgetary component (% of potential GDP)** | | -0.9 | -0.7 |
| **13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)** | | 0.6 | 0.2 |
| **14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)** | | 0.7 | 0.4 |
| **15. Structural balance (13 - 8) (% of potential GDP)** | | 0.9 | 0.8 |

1/ According to State Budget Draft 2014.
2/ TR-TE= B.9.
3/ The primary balance is calculated as (B.9, item 8) plus (D.41, item 9).
4/ A plus sign means deficit-reducing one-off measures.

*Source: Ministry of Finance.*

## Table 2.b. General government debt developments

| | ESA code | **2014*** | **2015*** |
|---|---|---|---|
| | | *% of GDP* | *% of GDP* |
| **1. Gross debt** [3] | | 9.8 | 9.3 |
| **2. Change in gross debt ratio** | | -0.3 | -0.4 |
| **Contributions to changes in gross debt** | | | |
| **3. Primary balance (=item 10 in table 2.a.i))** | | -0.2 | -0.4 |
| **4. Interest expenditure** | D.41 | 0.1 | 0.2 |
| **5. Stock-flow adjustment** | | -0.4 | -0.4 |
| of which: | | | |
| - Differences between cash and accruals | | – | – |
| - Net accumulation of financial assets | | – | – |
| of which: | | | |
| - privatisation proceeds | | – | – |
| - Valuation effects and other | | – | – |
| **p.m.: Implicit interest rate on debt (1/)** | | 1.4 | 1.6 |
| Other relevant variables | | | |
| 6. Liquid financial assets (2/) | | 8.8 | 7.7 |
| 7. Net financial debt (7=1-6) | | 0.9 | 1.7 |
| 8. Debt amortization (existing bonds) since the end of the previous year [4] | | 0.1 | 0.1 |
| 9. Percentage of debt denominated in foreign currency | | 0.0 | 0.0 |
| 10.Average maturity[5] | | 6.0 | 5.2 |

1/ Proxied by interest expenditure divided by the debt level of the previous year.
2/ Liquid assets are here defined as AF.1, AF.2, AF.3 (consolidated for general government, i.e. netting out financial positions between government entities), A.F511, AF.52 (only if quoted in stock exchange).

*Source: Ministry of Finance.*

## Table 2.c. Contingent liabilities

| | **2014*** | **2015*** |
|---|---|---|
| | *% of GDP* | *% of GDP* |
| Public guarantees | 1.7 | 1.6 |
| Of which: linked to the financial sector | 0.0 | 0.0 |

*Source: Ministry of Finance.*

[3] Forecast before Statistics Estonia published new general government debt data in September 2014. Forecast and explanatory note of the budget will be updated according to new time series by the end of year 2014 or at the beginning of year 2015.
[4] Central government borrowing without foundations and legal persons governed by public law.
[5] Central government without foundations and legal persons governed by public law.

# 3. Revenue and Expenditure Projections under the no-policy change scenario

Summer forecast (Table 3) differs from spring forecast partly because of general government total revenues in 2013 changed due to revision of 2012 data, which affected also the level of total expenditures. Indicators as percentage of GDP in spring and in summer (Table 3) are not comparable as the GDP has been revised.

**Table 3. General government expenditure and revenue projections at unchanged policies broken down by main components**

| General Government (S13) | ESA Code | 2014* | 2015* |
|---|---|---|---|
| | | *% of GDP* | *% of GDP* |
| **1. Total revenue at unchanged policies** | TR | 38.7 | 39.2 |
| **of which** | | | |
| **1.1. Taxes on production and imports** | D.2 | 13.9 | 14.4 |
| **1.2. Current taxes on income, wealth, etc** | D.5 | 7.5 | 7.1 |
| **1.3. Capital taxes** | D.91 | 0.0 | 0.0 |
| **1.4. Social contributions** | D.61 | 11.4 | 11.3 |
| **1.5. Property income** | D.4 | 1.4 | 1.2 |
| **1.6. Other** | | 4.5 | 5.3 |
| **p.m.: Tax burden** (=D.2+D.5+D.61+D.91-D.995) | | 32.8 | 32.7 |
| **2. Total expenditure at unchanged policies** | TE | 38.9 | 39.6 |
| **of which** | | | |
| **2.1. Compensation of employees** | D.1 | 10.9 | 10.8 |
| **2.2. Intermediate consumption** | P.2 | 6.8 | 6.7 |
| **2.3. Social payments** | D.62 D.632 | 12.6 | 13.0 |
| **of which Unemployment benefits** | | 0.4 | 0.3 |
| **2.4. Interest expenditure (=9. in Table 2.a)** | D.41 | 0.1 | 0.2 |
| **2.5. Subsidies** | D.3 | 0.7 | 0.8 |
| **2.6. Gross fixes capital formation** | P.51 | 5.5 | 5.1 |
| **2.7. Capital transfers** | D.9 | 0.8 | 0.8 |
| **2.8. Other** | | 1.4 | 2.2 |

*Source: Ministry of Finance.*

# 4. Expenditure and Revenue targets. General government expenditures by function

Budgetary Plan (Table 4.a) differs from summer forecast (Table 3) because of revenue and expenditure measures (Table 5.a). In 2014 revenues declined by 0.1% of GDP due to property income deferral, expenditures did not change. In 2015 revenues increased by 0.2% of GDP and expenditures by 0.3% of GDP.

**Table 4.a. General government expenditure and revenue targets, broken down by main components**

| General Government (S13) | ESA Code | 2014* | 2015* |
|---|---|---|---|
| | | % of GDP | % of GDP |
| 1. Total revenue target | TR | 38.5 | 39.3 |
| of which | | | |
| 1.1. Taxes on production and imports | D.2 | 13.9 | 14.4 |
| 1.2. Current taxes on income, wealth, etc | D.5 | 7.5 | 7.1 |
| 1.3. Capital taxes | D.91 | 0.0 | 0.0 |
| 1.4. Social contributions | D.61 | 11.4 | 11.3 |
| 1.5. Property income | D.4 | 1.3 | 1.3 |
| 1.6. Other | | 4.5 | 5.3 |
| p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995) | | 32.7 | 32.7 |
| 2. Total expenditure target | TE | 38.9 | 39.9 |
| of which | | | |
| 2.1. Compensation of employees | D.1 | 10.9 | 10.8 |
| 2.2. Intermediate consumption | P.2 | 6.8 | 6.9 |
| 2.3. Social payments | D.62 D.632 | 12.6 | 13.0 |
| of which Unemployment benefits | | 0.4 | 0.3 |
| 2.4. Interest expenditure (=9. in Table 2.a) | D.41 | 0.1 | 0.2 |
| 2.5. Subsidies | D.3 | 0.7 | 0.8 |
| 2.6. Gross fixes capital formation | P.51 | 5.5 | 5.2 |
| 2.7. Capital transfers | D.9 | 0.8 | 0.8 |
| 2.8. Other | | 1.4 | 2.2 |

*Source: Ministry of Finance.*

In accordance with SGP, the general government expenditure growth of a member state should conform to its GDP growth. This expenditure benchmark is usually the 10 year average potential GDP growth of the member state, which according to EC forecast is 2.1% for Estonia. If the member state does not fulfill its MTO (general government surplus for Estonia) for current year, the benchmark for the next will be set at a lower level (0.9% for Estonia), which will help the member state adjust its position and fulfill its MTO.

Expenditure growth[6] in 2014 will be 2%, which is in line with the benchmark. However, in 2015 the growth will be 5.6%, which means the benchmark will be exceeded by 3.5 pp, assuming that Estonia is at MTO. If Estonia will not be at MTO, lower benchmark will be used, which will be exceeded by 4.7 pp. There was a decrease in EU programmes spending in 2014 (Table 4.b), there will be an increase in 2015. Discretionary revenue measures decreased mainly due to the decrease in $CO_2$ emissions trading revenue. The decline in 2014 is mainly the result of unemployment insurance tax rate cut and the rise in 2015 will mainly be the result of excise rises and VAT regulation changes. Complying with the expenditure benchmark is additionally affected by higher than usual government investment in 2012–2014.

## Table 4.b. Expenditure benchmark

| | **2013** | **2013** | **2014*** | **2015*** |
|---|---|---|---|---|
| | *level (m EUR)* | *% of GDP* | *% of GDP* | *% of GDP* |
| **1. Government expenditure on EU programmes fully matched by EU funds revenue** | 869.6 | 4.64 | 4.26 | 4.51 |
| **2. Non-discretionary change in unemployment benefit expenditure [7]** | 0.0 | 0.00 | 0.00 | 0.00 |
| **3. Discretionary revenue measures [8]** | -21.1 | -0.11 | -0.17 | 0.15 |
| **4. Mandated revenue increases** | 0.0 | 0.00 | 0.00 | 0.00 |

*Source: Ministry of Finance.*

[6] In accordance with EC methodology, real expenditure growth is used using the GDP deflator. Excluded are interest expenditure and expenditures from table 4.b, also capital formation is smoothed over time.
[7] It is assumed that unemployment is at the natural rate.
[8] The measures accounted for: lowering the income tax rate; increase of basic and pension income tax allowance; increase in excise duties; abolition of fuel excise reduced rate; lowering the unemployment insurance tax rate; changes in VAT regulation; income tax on dividends; state budget employee wage rise tax receipts; the impact of disability system reform; revenue from $CO_2$ emissions trading; taxation of agricultural subsidies; increase in state duties; reverse charge of precious metals and stones; changes in gambling tax regulation.

## Table 4.c. General government expenditures by function

### Table 4.c.i) General government expenditure on education, healthcare and employment

| | 2014* | | 2015* | |
|---|---|---|---|---|
| | *% of GDP* | *% of general government expenditure* | *% of GDP* | *% of general government expenditure* |
| Education | 6.3 | 16.2 | 6.5 | 16.2 |
| Healthcare | 5.2 | 13.4 | 5.5 | 13.9 |
| Employment | 0.2 | 0.5 | 0.2 | 0.4 |

### Table 4.c.ii) Classification of the functions of the Government

| **Functions of the Government** | **COFOG Code** | **2014*** | **2015*** |
|---|---|---|---|
| | | *% of GDP* | *% of GDP* |
| 1. General public services | 1 | 3.6 | 3.6 |
| 2. Defence | 2 | 1.9 | 1.9 |
| 3. Public order and safety | 3 | 1.9 | 1.9 |
| 4. Economic affairs | 4 | 4.3 | 4.2 |
| 5. Environmental protection | 5 | 0.6 | 0.4 |
| 6. Housing and community amenities | 6 | 0.7 | 0.7 |
| 7. Health | 7 | 5.2 | 5.5 |
| 8. Recreation, culture and religion | 8 | 1.8 | 2.0 |
| 9. Education | 9 | 6.3 | 6.5 |
| 10. Social protection | 10 | 12.6 | 13.0 |
| **11. Total expenditure (=2. in Table 2.c.i)** | **TE** | **38.9** | **39.9** |

*Source: Ministry of Finance.*

# 5. Description of discretionary measures included in the draft budget

There are 14 measures (with impact over 1 million Euros) that have an impact on state budget revenues and expenditures in 2015. Two of them have an impact on state budget revenues, 11 of them affect state budget expenditures and one has an effect on expenditures of Unemployment Insurance Fund. All expenditure measures (total of 44.4 million Euros) are one-off measures and they are channelled to cover the priority needs of the ministries. Taking into account all the measures, general government deficit will deepen by 20.6 million Euros or 0.1% of GDP in 2015.

Dividend rescheduling including income tax – partial rescheduling of dividends from year 2014 to year 2015. The measure will affect the state-owned enterprises, as their liquidity will increase.

State duties – duty rates will increase because of an increase in actual cost of operations and rounding of duty rates up to full Euros.

Expenditure on preparation of working age disability system reform – in 2016 the working age disability system reform will start and preparation expenditure (IT-systems, retraining of employees, recruitment of new employees) is made in 2015.

State defence expenditures – partial compensation of decrease of state defence expenditures that declined due to the decrease of GDP.

**Table 5.a. Discretionary measures taken by General Government**

| List of measures | Detailed description | Target (exp / rev component) ESA Code | Accounting principle | Adoption status | Budgetary impact | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | 2014* | 2015* | 2016* | 2017* |
| | | | | | *% of GDP* | *% of GDP* | *% of GDP* | *% of GDP* |
| 1) State duty | Raising of state duties. | Revenue | Accrual method | Draft included in the State Budget | – | 0.02 | 0.02 | 0.02 |
| 2) Dividend rescheduling including income tax | Dividend rescheduling from year 2014 to year 2015. | Revenue, D4, D5 | Accrual method | Draft is not required | -0.14 | 0.14 | – | – |
| 3) Reform of ability to work (Unemployment Insurance Fund) | In 2016 the reform of ability to work will start. In order to implement the reform preparation expenditure is planned in year 2016. | Expenditure, P2 | Accrual method | Draft is being coordinated | – | -0.04 | – | – |
| 4) Growth of state defence expenditures | Partial compensation of (due to the decrease of GDP) decreased state defence expenditures; providing support to recipient of reinforced Baltic Air Policing. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.06 | – | – |
| 5) Procuring grounds valuable by nature | Nationalized valuable grounds to compensate the private owner's wildlife preserve restrictions. | Expenditure, P51 | Accrual method | Draft is not required | – | -0.02 | – | – |
| 6) Providing winter navigation | Year 2015 icebreaking cost in Gulf of Finland. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 7) Development and humanitarian aid | For development cooperation and humanitarian aid activity there are projects with development cooperation target states, donations to international organizations/funds, humanitarian aid, informational activity and world education in Estonia. | Expenditure, D3 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 8) Procuring items for science libraries | Compiling science and development literature; international electronical items database user licenses. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 9) Preparation of the 100th birthday of the Republic of Estonia | Expenditures of preparation for the 100th birthday of the Republic of Estonia. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 10) IT Academy program | Expenditure related to the IT Academy Program. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 11) IKT development | Information and communication technology, several state IT developments. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 12) Estonian presidency of Council of Europe – planning and implementing action plan | Preparation and arrangement expenditure for Estonian presidency in 2018. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 13) Development of IT systems | Information and communication technology, several state IT developments. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 14) Evolving and realizing of the IT system which is necessary for the implementation of 2014–2020 program period measures | Evolving the support system for applying new principles of developing agriculture, country life and fishing sphere financial distribution. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 15) Other expenditure | Small expenditure decisions for all ministries – carrying costs, investments etc. | Expenditure | Accrual method | Draft is not required | – | -0.07 | – | – |
| **Total revenue measures** | | | | | **-0.14** | **0.16** | **0.02** | **0.02** |
| **Total expenditure measures** | | | | | **–** | **-0.26** | **–** | **–** |
| **TOTAL** | | | | | **-0.14** | **-0.10** | **0.02** | **0.02** |

*Source: Ministry of Finance.*

## Table 5.b. Discretionary measures taken by Central Government

| List of measures | Detailed description | Target (exp / rev component) ESA Code | Accounting principle | Adoption status | Budgetary impact | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | 2014* | 2015* | 2016* | 2017* |
| | | | | | *% of GDP* | *% of GDP* | *% of GDP* | *% of GDP* |
| 1) State duty | Raising of state duties. | Revenue | Accrual method | Draft included in the State Budget | – | 0.02 | 0.02 | 0.02 |
| 2) Dividend rescheduling including income tax | Dividend rescheduling from year 2014 to year 2015. | Revenue, D4, D5 | Accrual method | Draft is not required | -0.14 | 0.14 | – | – |
| 3) Growth of state defence expenditures | Partial compensation of (due to the decrease of GDP) decreased state defence expenditures; providing support to recipient of reinforced Baltic Air Policing. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.06 | – | – |
| 4) Procuring grounds valuable by nature | Nationalized valuable grounds to compensate the private owner's wildlife preserve restrictions. | Expenditure, P51 | Accrual method | Draft is not required | – | -0.02 | – | – |
| 5) Providing winter navigation | Year 2015 icebreaking cost in Gulf of Finland. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 6) Development and humanitarian aid | For development cooperation and humanitarian aid activity there are projects with development cooperation target states, donations to international organizations/funds, humanitarian aid, informational activity and world education in Estonia. | Expenditure, D3 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 7) Procuring items for science libraries | Compiling science and development literature; international electronical items database user licenses. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 8) Preparation of the 100th birthday of the Republic of Estonia | Expenditures of preparation for the 100th birthday of the Republic of Estonia. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 9) IT Academy program | Expenditure related to the IT Academy Program. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 10) IKT development | Information and communication technology, several state IT developments. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 11) Estonian presidency of Council of Europe – planning and implementing action plan | Preparation and arrangement expenditure for Estonian presidency in 2018. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 12) Development of IT systems | Information and communication technology, several state IT developments. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 13) Evolving and realizing of the IT system which is necessary for the implementation of 2014–2020 program period measures | Evolving the support system for applying new principles of developing agriculture, country life and fishing sphere financial distribution. | Expenditure, P2 | Accrual method | Draft is not required | – | -0.01 | – | – |
| 14) Other expenditure | Small expenditure decisions for all ministries – carrying costs, investments etc. | Expenditure | Accrual method | Draft is not required | – | -0.07 | – | – |
| **Total revenue measures** | | | | | **-0.14** | **0.16** | **0.02** | **0.02** |
| **Total expenditure measures** | | | | | **–** | **-0.22** | **–** | **–** |
| **TOTAL** | | | | | **-0.14** | **-0.06** | **0.02** | **0.02** |

*Source: Ministry of Finance.*

# 6. Links between the draft budgetary plan and the targets set by the Union's Strategy for growth and jobs and country specific recommendations

In this chapter information is presented on how the measures in draft budget plan take into account the country-specific recommendations (CSR) and contribute to Europe 2020 objectives for growth and jobs.

More comprehensive and detailed information on the measures implemented is available in the strategy for competitiveness "Estonia 2020" and its action plan (Estonian national reform programme).[9]

[9] http://ec.europa.eu/europe2020/pdf/csr2014/ap2014_estonia_en.pdf,
http://ec.europa.eu/europe2020/pdf/csr2014/nrp2014_estonia_en.pdf.

## Table 6.a. Country-specific recommendations

| CSR no | List of measures | Description of direct relevance |
|---|---|---|
| **1.** | a) The new state budget law enters into force | Implementation of the requirement that the structural budget position must be in balance or in surplus: According to the state budget for 2015, the structural budget position of the general government sector is in a surplus of 0.8 percent of GDP, which is more ambitious by 0.6 percentage points than initially set in the budget strategy.<br>The Fiscal Council assesses the state macroeconomic forecasts and the state financial forecasts and monitors the compliance with the budgetary rules.<br>Of implementing acts, a new regulation on strategic planning enters into force, specifying the bases defined in the Act for better linking of the objectives, actions and resources. |
| **2.** | a) Reduction of labour taxes | The personal income tax rate is reduced from 21% to 20%, the unemployment insurance premium rate from 3% to 2.4% and basic exemption limit increases from 144 Euros per month to 154 Euros per month. |
| | b) An increase in child benefits, including means-tested child benefits | The child benefits for the first and second child increase to 45 Euros per month and for the third child to 100 Euros per month. The means-tested family allowance to low-income families doubles. The weight of the existence of children in granting subsistence benefits increases from 0.8 to 1.0. |
| | c) Preparations for capacity for work reform | Preparations for the year 2016 implementation of the capacity for work support scheme and a capacity for work evaluation system as well as for the provision of labour market measures (incl work related rehabilitation) and social services to the target group and employers. |
| | d) Supporting labour market participation | The funding of welfare measures and the development of childcare and welfare services for children with disabilities to reduce the burden of care. |
| | e) Additional kindergarten places | Additional kindergarten places are created, in particular in bigger towns and their outskirts, to ensure healthy and safe development of children and young people. |
| | f) Improvement of the business environment in the areas of highest unemployment | Implementation of the strengthening the regional competitiveness measure to improve business environment and employment (incl in areas with highest unemployment), measure intended to support the sustainable development of the urban areas in Ida-Viru County; continued development of the industrial areas of Ida-Viru County. |

| | | |
|---|---|---|
| **3.** | a) Better matching of labour market needs and training | The implementing of a coordination system for labour market monitoring and forecasting and skills development, aimed at better matching the needs of the labour market needs and the provision of training. The first sectoral expert committees define, under the leadership of the Estonian Qualifications Authority, the key professions and the demand for such people, the labour market relevance of education and training, the capacity of educational institutions as well as the level of skills and knowledge of employees and the need for continuous training. Development and support for the regional entrepreneurship and employment plans begins. |
| | b) More efficient organisation of work placement | Disseminating the best practices of organising work placement to increase the awareness of employers and educational institutions about the importance and organisation of work placement. Development of incentives to increase the interest of enterprises in providing work placement opportunities. Promoting the apprenticeship system among employers and the target group. |
| | c) Supporting education support services incl career services | The provision of systematic counselling services to all age groups in order to promote informed choices; the development of a single user-friendly career counselling system to assist people who wish to improve their professional skills or to learn a new profession or to change their working life. For implementation of Life Long Learning strategy, a programme for study and career counseling will be compiled, targeted at children and youth up to 26 years. |
| | d) Continuing the reorganisation of the school network | The reorganisation of the network of upper secondary schools and launch of an investment programme with a view to improving the quality of the school network, including modernising the infrastructure and optimising the use of resources. |
| | e) Improving ICT competences | Promoting the learning of basic ICT skills in general educational schools (primarily in basic school) and among adults who do not use information technology and increasing the awareness of the opportunities and risks of the information society among the population of Estonia. |
| | f) Promoting innovation | Implementation of new entrepreneurship measures: starting business assistance, the Start-up Estonia programme, financial instruments (guarantees, loans, export insurance and credit insurance); innovation vouchers. Promoting systematic cooperation between companies and research institutions via improving technology development centres. Entrepreneurs have an opportunity to participate in business clusters intended to increase added value and marketing capacity. Taylor-made diagnostics services and assistance to individual enterprises. |

| | | |
|---|---|---|
| **4.** | a) Towards taxing consumption and use of resources | Increasing the excise duty on natural gas and partial abolishing of the excise duty incentive on fuel marked with a fiscal marker. Increasing the excise duty rates on alcohol and tobacco. |
| | b) Promoting public transport | Increasing subsidies on all types of public transport subsidized by the government. |
| | c) Improving the quality of public transport | Improving the quality of public transport services, including preparing for the introduction of new trams and reconstructing tramway tracks in Tallinn. |
| | d) Increasing the efficiency of energy consumption by local authorities | Construction of new, energy-efficient street lighting installations in seven Estonian towns. |
| | e) Measures to increase the energy efficiency of buildings | Implementing the package of investments into energy conservation for the reconstruction of apartment buildings. |
| | f) Energy-performance labelling of vehicles | Starting the development of the energy label with a view to improving the energy-efficiency of the vehicle fleet. |
| | g) Alternative energy sources in the transport sector | Encouraging the introduction of environmentally friendly technologies and alternative fuels. |
| | h) Cross-border energy infrastructures | Continuing cooperation to establish connections (neighbouring electricity systems) and build infrastructure facilities (e.g. LNG Terminal) and creating conditions for connecting Estonian grid to the synchronous grid of Continental Europe. |
| **5.** | a) Programme of implementing institutional changes in the organisation of local government | Determining which local government duties are performed at which levels, how the performance of those duties is funded and how to make the cooperation between local governments and between local governments and the state more efficient. |
| | b) Describing the criteria for the provision of services by areas | Creating preconditions for implementing conditional minimum requirements to improve the quality of local government services in the field of social welfare. |
| | c) Organisation of regional public transport | Continuing the establishment of regional public transport centres and shifting the organisation of public transport from the level of counties to the level of larger regions covering several counties. |

## Table 6.b. Targets set by the Union's Strategy for growth and jobs

| National 2020 headline targets | List of measures | Description of direct relevance to address the target |
|---|---|---|
| National employment target [76%] | 1. Improving possibilities for labour participation | Labour market services for retirement-aged job-seekers are ensured, additional services for youth to work and mobility measure is elaborated and piloted to increase peoples readiness to work in further distance from home. |
| | 2. Implementation of the employment programme 2014–2015 | Extending the range of service users, focusing on young people, the elderly, old-age pensioners, long-term unemployed, people with reduced capacity for work. |
| | 3. Supporting staying in and returning to employment | Ensuring accessible and high-quality health services in order to promote staying in and returning to employment. |
| | 4. Maintaining capacity for work | Reorganizing the systems of occupational health and safety and settlement of labour disputes. |
| | 5. Implementation of capacity for work reform | New methodology for assessing the capacity to work is elaborated and measures for helping people with reduced capacities to start or maintain a job are ensured. |
| | 6. Increasing availability of career services | By providing career counseling to working age population moving between jobs is supported, becoming jobless prevented and unemployment period shortened. |
| National R&D target [3% of GDP] | 1. Institutional research grants | Funding institutional research grants, targeted financing of research topics and infrastructure maintenance costs. |
| | 2. Research agency support | Ensuring the funding of basic and applied research as well as research and development. |
| | 3. Cooperation with the European research excellence infrastructure | Funding the cooperation agreement between the Republic of Estonia and the European Laboratory for Particle Physics (CERN). |
| GHG emission reduction target [6,269 thousand tons (+10% compared to 2005)]<br>Renewable energy target [25%]<br>National energy efficiency target [2,818 ktoe] | 1. Implementation of the new National Development Plan of the Energy Sector until 2030 | The objectives of the National Development Plan of the Energy Sector are:<br>1) to ensure energy supply in the electricity, heat, transport and housing sectors as well as in the sector of the production of domestic fuels;<br>2) to reduce the energy intensity of the economy (without compromising competitiveness) and increase energy efficiency;<br>3) to increase energy security through the development of the business environment required for energy production, infrastructure and connections. |
| | 2. Implementing new structural funds | The focus is on increasing the use of alternative fuels in transport, the efficiency of heat production and transmission, energy conservation and the share of renewable energy. |

| | | |
|---|---|---|
| Early leavers from education and training (age 18–24) [9,5%] | 1. Reorganisation of the national school network | Continuing the programme of building and renovating upper secondary schools in county centres, including state upper secondary schools, and supporting the optimisation of the use of the premises of schools that abolish the upper secondary level and merging basic schools. |
| | 2. Supporting schools through school meals | Free school meals provided to upper secondary pupils. |
| | 3. Education support services incl career services | Counseling services provides for making informed choices, study counseling prevents dropping out of school. |
| National target for tertiary education [40%] | 1. Means-tested education allowance and performance scholarships | The provision of means-tested education allowance to a wider range of beneficiaries; increasing the fund of performance scholarships in higher education. |
| National poverty target [15%[10]] | 1. Supporting families with children | The means-tested family allowance to low-income families doubles. The weight of the existence of children in granting subsistence benefits increases from 0.8 to 1.0. |
| | 2. Pensions increase by 5.8% on average; the amount of income exempt from personal income tax is increased for pensioners | The average old-age pension is increased from 353 to 374 Euros. Increasing tax exemption of pensions continues - the amount of pension exempt from personal income tax is 374 Euros. |

[10] Relative poverty rate after social transfers.

# 7. Divergence from latest Stability Program

Estonian Stability Program 2014 was based on spring forecast of the Ministry of Finance, published on 7 April 2014. State budget of 2015 is based on the summer economic forecast, published on 1 September 2014.

According to the spring forecast of the Ministry of Finance economic growth for 2014 was expected to be 2.0%. During 2015–2016 we expected the growth rate to pickup to 3.5% and 3.6% respectively. However, in the first half of 2014 GDP real growth figures were weaker than expected in the previous forecast because main export markets cut their growth outlook. Therefore economic growth forecast was lowered to 0.5% in 2014 because of lower domestic demand and export growth. GDP growth forecast for 2015–2016 was cut by 1.0 and 0.1 percentage points. Main reason behind lowering the forecast is weaker exports, at the same time domestic demand will grow at smaller rate as well. Forecast for next years growth has not changed compared to the spring forecast. As a result of downwards revision of GDP components and inflation, nominal growth forecast will be lower. Nominal GDP will be 0.3 billion Euros in 2014 and 0.6 billion Euros in 2015 and 2016 smaller compared to spring projection.

Contribution of domestic demand to GDP growth will be smaller in 2014 and 2015 than forecasted in spring but the correction is smaller than in case of total output. Private consumption growth will be slightly lower but investment growth may turn negative temporarily. Increase in investment activity presumes demand pickup in export markets, which is not realizing as assumed half a year ago, magnified by the Russian-Ukrainian conflict. Investment growth has been revised from +0.7% to -0.4% in 2014, but next year growth pickup should be faster than forecasted in spring. Private consumption will be close to 3.6%, which is marginally lower than expected in spring, due to lower purchases of durables and consumption of housing related services in the first quarter. Nominal growth was revised down more than real because of downward revision of inflation. Growth should recover to 3.8% next year as forecasted in spring.

Weaker demand on export markets and to a lesser extent Russian import ban on food products caused lowering the export forecast by 0.4 pp in 2014 and 2.5 pp in 2015. Export growth in next year's will be lower as well due to slower recovery of foreign demand. As the forecast of imports was cut by somewhat smaller extent, the current account deficit will widen in coming years compared to spring forecast.

CPI inflation forecast will be 1.1 pp lower in 2014 and 0.8 pp lower in 2015 compared to spring forecast. Forecast has been lowered mainly due to foreign factors as decline in import prices was bigger than expected. To a larger extent it has affected imported food prices, which are declining due to favorable weather conditions and increased supply. Although excise tax increases will contribute to CPI since 2015, their impact will counterbalance smaller impact from foreign factors and smaller increase in service prices. Inflation forecast in the end of forecast horizon has been raised due to additional excise duty increases.

The slight employment increase, which was forecasted in spring (+0.3%) will probably not materialize next year. Instead the peak in employment will be reached and a long lasting decline trend will begin starting 2016. Higher expectations on demand in spring promised slight increase in employment also next year, taking into account the availability of spare labour resources, but continuously depressed aggregate demand does not encourage businesses to hire in the near future. Diminishing working-age population in next years will give no chance for employment growth. Average nominal wage growth expectations have not changed compared to spring, but real wage growth will be slightly higher in 2014 and 2015 due to lower expected inflation.

The general government budgetary position in 2014 has improved by 0.4 % of GDP to -0.3% of GDP compared to spring forecast. Improvement is caused mainly by increased tax revenues (especially VAT and fuel excise duty due to better than expected receipts in the first half of the year and planned tax policy changed). Also the forecasted pension expenditures have somewhat decreased. The general government nominal deficit in 2015 has stabilised at 0.5 % of GDP compared to SP. Like in 2014 the general government budgetary position of 2015 is influenced by increased forecast of tax revenues. However, the lower revenue from social tax and personal income tax caused by weaker labour market reduces positive impact of increased VAT and fuel excise duty revenues. The budgetary position is negatively affected by decrease in unemployment insurance contribution rates.

Compared to Stability Program, the forecast of tax burden in 2014 has increased by 0.3% to 32.7% of GDP (expectations for VAT and excise duty revenues were increased). Tax burden in 2015 has increased by 0.4% to 32.7% of GDP (tax revenues remained almost the same, the change was caused by downward correction of GDP forecast).

Forecast of general government debt for years 2014 and 2015 has not changed compared to the forecast included in the Stability Program.

## Table 7.a. Deviation from the last Stability Program – structural budgetary balance

| | ESA Code | 2013 | 2014* | 2015* |
|---|---|---|---|---|
| | | % of GDP | % of GDP | % of GDP |
| **General government structural balance (1/) target** | B.9 | | | |
| **Stability Program** | | 0.1 | 0.7 | 0.2 |
| **Draft Budgetary Plan** | | 0.0 | 0.9 | 0.8 |
| **Difference** | | -0.1 | 0.2 | 0.6 |
| **General government structural balance projection at unchanged policies** | B.9 | | | |
| **Stability Program** | | 0.1 | 0.7 | 0.2 |
| **Draft Budgetary Plan** | | 0.0 | 0.9 | 0.8 |
| **Difference** | | -0.1 | 0.2 | 0.6 |

1/ Budgetary position is targeted by structural balance.
*Source: Statistics Estonia, Ministry of Finance.*

## Table 7.b. Deviation from the last Stability Program – net lending/net borrowing

| | ESA Code | 2013 | 2014* | 2015* |
|---|---|---|---|---|
| | | % of GDP | % of GDP | % of GDP |
| **General government net lending/ net borrowing target** | B.9 | | | |
| **Stability Program** | | -0.7 | 0.0 | -0.5 |
| **Draft Budgetary Plan** | | -0.5 | -0.3 | -0.5 |
| **Difference** | | 0.2 | -0.3 | 0.0 |
| **General government net lending/ net borrowing projection at unchanged policies** | B.9 | | | |
| **Stability Program** | | -0.7 | 0.0 | -0.5 |
| **Draft Budgetary Plan (1/)** | | -0.5 | -0.2 | -0.5 |
| **Difference** | | 0.2 | -0.2 | 0.0 |

1/ Actual (t-1) and summer forecast (t, t+1).
*Source: Statistics Estonia, Ministry of Finance.*

# 8. Distributional effects of main revenue and expenditure measures

Gini coefficient for Estonia, which indicates the income distribution of the population (larger index denominates larger inequality), was 0.329 in 2013. This is rather large compared to EU as a whole and to northern neighbours of Estonia and it has increased by 2 percentage points during past five years. Countries with larger indices in 2013 were as follows: Latvia, Lithuania, Bulgaria, Romania, Greece, Spain and Portugal. However, comparison with states with different sizes and development levels might not always be appropriate because in bigger countries the difference of income levels in different regions is less apparent to residents.

Most of the planned revenue and expenditure measures either will not have a distributional effect or the effect is very indirect and non-quantifiable. Examples of these are partial rescheduling of state-owned enterprises dividends from 2014 to 2015, increasing the defence costs or minor raise of expenditures to achieve the ministries operational objectives. Of the measures which do effect the income distribution, none has such a large effect that it could change the numerical value of the Estonian Gini coefficient or the S80/S20 ratio. None of the measures has an effect on the poverty ratio.

# Annex 1: Methodology, economic models and assumptions

## Table 8. Methodological aspects

| Estimation Technique | Step of the budgetary process for which it was used | Relevant features of the model / technique used | Assumptions |
|---|---|---|---|
| Expert forecast | Compilation of macroeconomic forecast | GDP forecast is being compiled using the production, expenditure and income approach and the consistency is controlled with MS Excel. Experts are monitoring economic fields (labor market, economic sectors, prices, loan behavior, consumption, etc.) and are suggesting possible trends, which will be modified consistent through iterations. | o Saving rate of households has stabilized and will not change over forecast period.<br>o Growth of main export markets will speed up gradually.<br>o EUR/USD Exchange rate will be constant.<br>o Oil prices are declining. |

# Annex 2: Impact of Russian sanctions on Estonian exports

The share of Russia in exports has fluctuated between 10–12% in recent years and is ranked as third export market behind Sweden and Finland. Exports to Russia have been raised markedly by growing transport of goods produced in other countries during last year's. This is re-exports, which increased foreign trade volumes but its impact on value added is small. This kind of business appears in services exports, as Estonian companies offer storage and transport services. Statistics Estonia has estimated that re-exports to Russia constituted more than 50% of total exports to Russia in 2012.

Estonia exported agricultural products and foodstuffs to Russia in the value of 239.4 million Euros in 2013, but *ca* 60% from this constituted beverages, cocoa and coffee, which is also mostly re-exports. Main export markets of agricultural products and foodstuffs are Finland, Latvia and Lithuania. The share of Russia without those re-exported food products reached *ca* 10%.

On 6 November, Russia imposed import ban on different food products (beef, pork, fruit and vegetables, poultry, fish, cheese, milk and milk products) from EU, USA, Australia, Canada and Norway. Estonian companies exported goods under the sanctions to Russia in 2013 in the amount of 75 million Euros and in first half of 2014 in the amount of 28 million Euros. During the first 6 months of 2014 exports of goods under sanctions to Russia declined markedly (-27%). This is because Russian sanitary sanctions were introduced to several companies already in January 2014 and therefore exports of milk and fish products to Russia declined in the first half of 2014 (decline in milk products by 36%). Already earlier were banned exports of live animals and since January 2014 the exports of pork as well. Therefore, our food industry received already an impact from the incalculable behavior of Russia before the August import ban. Thence exports of milk products were channelled partly to Lithuania instead of Russia.

The direct effect of Russian import ban on food products is taken into account in summer economic forecast – sanctions will reduce exports of food products to Russia by *ca* 50 million Euros. This constitutes small part of Estonian goods exports (0.4%) but worsens business of producers and industries in the situation, where finding new markets is hampered by overbidding. Road transport will suffer as well, because goods transports towards Russia formed 29% of total shipment volumes in 2013. The share of food products in there is difficult to estimate due to lack of correct data.

Import ban was softened on 20 August, while some food products were excluded from the ban list. From this Estonia should benefit to a bigger extent by enabling exports of lactose free milk and its articles. The forecast has not taken into account this step. The indirect impact to consumer prices via possible oversupply of food products in EU markets and the following price decreases has been added to risk scenario.

To sum up, Russian import ban will affect mostly agriculture, food industry and road transport. Bank of Estonia has estimated, that based on the data of 2013, the direct impact of the sanctions on Estonian GDP will reach 0.2–0.3%.