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Recommendation for a

COUNCIL RECOMMENDATION

on the 2023 National Reform Programme of Estonia and delivering a Council opinion on the 2023 Stability Programme of Estonia

{SWD(2023) 606 final}

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Recommendation for a

COUNCIL RECOMMENDATION

on the 2023 National Reform Programme of Estonia and delivering a Council opinion on the 2023 Stability Programme of Estonia

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 Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

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) Regulation (EU) 2021/241 of the European Parliament and of the Council[3], which established the Recovery and Resilience Facility, entered into force on 19 February 2021. The Recovery and Resilience Facility provides financial support to the Member States for the implementation of reforms and investments, entailing a fiscal impulse financed by the EU. In line with the European Semester priorities, it contributes to economic and social recovery and to the implementation of sustainable reforms and investments, in particular to promote the green and digital transition and make the Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the EU and support the continued implementation of the European Pillar of Social Rights. The maximum financial contribution per Member State under the Recovery and Resilience Facility was updated on 30 June 2022, in accordance with Article 11(2) of Regulation (EU) 2021/241.

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.
[3] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

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(2) On 22 November 2022, the Commission adopted the 2023 Annual Sustainable Growth Survey,[4] marking the start of the 2023 European Semester for economic policy coordination. The European Council endorsed the priorities of the survey around the four dimensions of competitive sustainability on 23 March 2023. On 22 November 2022, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the 2023 Alert Mechanism Report, in which it identified Estonia as one of the Member States that may be affected or may be at risk of being affected by imbalances, and for which an in-depth review would be needed. On the same date, the Commission also adopted an opinion on Estonia's 2023 draft budgetary plan. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which the Council adopted on 16 May 2023, as well as the proposal for the 2023 Joint Employment Report analysing the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights, which the Council adopted on 13 March 2023.

(3) While the EU economies are showing remarkable resilience, the geopolitical context continues to have a negative impact. As the EU stands firmly with Ukraine, the EU economic and social policy agenda is focused on reducing the negative impact of energy shocks on both vulnerable households and companies in the short term, and on keeping up efforts to deliver on the green and digital transition, support sustainable and inclusive growth, safeguard macroeconomic stability, and increase resilience in the medium term. It also focuses heavily on increasing the EU's competitiveness and productivity.

(4) On 1 February 2023, the Commission issued the Communication *A Green Deal Industrial Plan for the Net-Zero Age'*[5] to boost the competitiveness of the EU's net-zero industry and support the fast transition to climate neutrality. The plan complements ongoing efforts under the European Green Deal and REPowerEU. It aims to provide a more supportive environment for scaling up the EU's manufacturing capacity for the net-zero technologies and products required to meet the EU's ambitious climate targets, as well as ensuring access to relevant critical raw materials, including by diversifying sourcing, properly exploiting geological resources in Member States and maximising the recycling of raw materials. The plan is based on four pillars: a predictable and simplified regulatory environment, speeding up access to finance, enhancing skills, and open trade for resilient supply chains. On 16 March 2023, the Commission also issued the Communication *Long-term competitiveness of the EU: looking beyond 2030*[6], structured along nine mutually reinforcing drivers with the objective to work towards a growth enhancing regulatory framework. It sets policy priorities aimed at actively ensuring structural improvements, well focused investments and regulatory measures for the long-term competitiveness of the EU and its Member States. The recommendations below help address those priorities.

(5) In 2023, the European Semester for economic policy coordination continues to evolve in line with the implementation of the Recovery and Resilience Facility. Fully implementing the recovery and resilience plans remains essential for delivering the policy priorities under the European Semester, as the plans address all or a significant subset of the relevant country-specific recommendations issued in recent years. The 2019, 2020 and 2022 country-specific recommendations remain equally relevant also

[4] COM(2022) 780 final.
[5] COM(2023) 62 final.
[6] COM(2023) 168 final.

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for recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.

(6) The REPowerEU Regulation[7], adopted on 27 February 2023, aims to rapidly phase out the EU's dependence on Russian fossil fuel imports. This will contribute towards energy security and the diversification of the EU's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. The Regulation enables Member States to add a new REPowerEU chapter to their national recovery and resilience plans in order to finance key reforms and investments that will help achieve the REPowerEU objectives. They will also help boost the competitiveness of the EU's net-zero industry as outlined in the Green Deal Industrial Plan for the Net-Zero Age and address the energy-related country-specific recommendations issued to the Member States in 2022 and, where applicable, in 2023. The REPowerEU Regulation introduces a new category of non-repayable financial support, made available to Member States to finance new energy-related reforms and investments under their recovery and resilience plans.

(7) On 8 March 2023, the Commission adopted a communication providing fiscal policy guidance for 2024. It aims to support the preparation of Member States' stability and convergence programmes and thereby strengthen policy coordination[8]. The Commission recalled that the general escape clause of the Stability and Growth Pact will be deactivated at the end of 2023. It called for fiscal policies in 2023-2024 that ensure medium-term debt sustainability as well as raise potential growth in a sustainable manner. Member States were invited to set out in their 2023 stability and convergence programmes how their fiscal plans will ensure that the 3% of GDP deficit reference value is adhered to as well as plausible and continuous debt reduction, or for debt to be kept at prudent levels in the medium term. The Commission invited Member States to phase out national fiscal measures introduced to protect households and firms from the energy price shock, starting with the least targeted ones. It indicated that, if support measures needed to be extended because of renewed energy pressures, Member States should target such measures much better than in the past towards vulnerable households and firms. The Commission proposed that the fiscal recommendations would be quantified and differentiated and be formulated on the basis of net primary expenditure as proposed in its Communication on orientations for a reform of the EU economic governance framework[9]. It recommended that all Member States should continue to protect nationally financed investment and ensure the effective use of the Recovery and Resilience Facility and other EU funds, in particular in light of the green and digital transitions and resilience objectives. The Commission indicated that it will propose to the Council to open deficit-based excessive deficit procedures in spring 2024 on the basis of the outturn data for 2023, in line with existing legal provisions.

(8) On 26 April 2023, the Commission presented legislative proposals to implement a comprehensive reform of the EU's economic governance rules. The central objective of the proposals is to strengthen public debt sustainability and promote sustainable and

[7] Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1).

[8] COM(2023) 141 final.

[9] COM(2022) 583 final.

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inclusive growth in all Member States through reforms and investment. The proposals aim at providing Member States with more control over the design of their medium-term plans, while putting in place a more stringent enforcement regime to ensure that Member States deliver on the commitments undertaken in their medium-term fiscal-structural plans. The objective is to conclude the legislative work in 2023.

(9) On 18 June 2021, Estonia submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of Regulation (EU) 2021/241, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines of Annex V to that Regulation. On 29 October 2021, the Council adopted its Decision on the approval of the assessment of the recovery and resilience plan for Estonia[10]. The release of instalments is conditional on a decision by the Commission, taken in accordance with Article 24(5) of Regulation (EU) 2021/241, that Estonia has satisfactorily fulfilled the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory fulfilment presupposes that the achievement of preceding milestones and targets has not been reversed. On 9 March 2023, Estonia submitted a revised national recovery and resilience plan, including a REPowerEU chapter, to the Commission, in accordance with Article 21c of Regulation (EU) 2021/241. The revised recovery and resilience plan also takes into account the updated maximum financial contribution in accordance with Article 18(2) of Regulation (EU) 2021/241 and includes a reasoned request to the Commission to amend the Council Implementing Decision of 3 November 2021 in accordance with Article 21(1) of Regulation (EU) 2021/241, considering the recovery and resilience plan to be partially no longer achievable due to objective circumstances. On 12 May 2023, the Commission adopted its proposal for a Council Implementing Decision on the approval of the assessment of the recovery and resilience plan for Estonia. [The Council adopted the modified Council Implementing Decision on XX XXXX 2023.] .

(10) On XX May 2023, Estonia submitted its 2023 National Reform Programme and, on 28 April 2023, its 2023 Stability Programme, in line with Article 4(1) of Regulation (EC) No 1466/97. To take account of their interlinkages, the two programmes have been assessed together. In accordance with Article 27 of Regulation (EU) 2021/241, the 2023 National Reform Programme also reflects Estonia's biannual reporting on the progress made in achieving its recovery and resilience plan.

(11) The Commission published the 2023 country report for Estonia[11] on 24 May 2023. It assessed Estonia's progress in addressing the relevant country-specific recommendations adopted by the Council between 2019 and 2022 and took stock of Estonia's implementation of the recovery and resilience plan. Based on this analysis, the country report identified gaps with respect to those challenges that are not addressed or only partially addressed by the recovery and resilience plan, as well as new and emerging challenges. It also assessed Estonia's progress on implementing the European Pillar of Social Rights and on achieving the EU headline targets on employment, skills and poverty reduction, as well as progress in achieving the UN's Sustainable Development Goals.

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[10] Council Implementing Decision of 29 October 2021 on the approval of the assessment of the recovery and resilience plan for Estonia (ST 12532/21; ST 12532/21 ADD 1; ST 12532/21 ADD 1 COR 1; ST 12532/21 ADD 1 COR 1 REV 1).

[11] SWD(2023) 606 final.

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(12) The Commission carried out an in-depth review under Article 5 of Regulation (EU) No 1176/2011 for Estonia and published its results on 24 May 2023[12]. It concluded that Estonia is not experiencing macroeconomic imbalances. In particular, vulnerabilities relating to competitiveness and house price developments have recently increased but overall seem to be contained at present. Wages and especially prices grew strongly in 2022, but the competitiveness losses seem limited, while the current account has recorded only a small deficit and is forecast to come close to balance this year and next. Nonetheless, inflation and wage pressures, if persistent, risk impairing Estonia's competitiveness, particularly as core inflation is well above the euro area average. House prices have grown strongly since the pandemic, but do not show signs of overvaluation. House prices are likely to moderate, given the interest rate rises and the recent economic recession. Moreover, household debt and borrowing are relatively moderate and the financial sector is sound. The policy setting is overall favourable, although some additional efforts could help to address the risks from the identified vulnerabilities. Continued counter-cyclical fiscal and macroprudential policies, reinforced when needed, would be important in that respect. Fostering competition in the domestic market could help to manage price pressures.

(13) Based on data validated by Eurostat,[13] Estonia's general government deficit decreased from 2.4% of GDP in 2021 to 0.9% in 2022, while general government debt rose from 17.6% of GDP at the end of 2021 to 18.4% at the end of 2022. On [24 May] 2023, the Commission published a report under Article 126(3) TFEU;[14] the report discussed the budgetary situation of Estonia, as its general government deficit is planned to exceed 3% of GDP in 2023. The report concluded that the deficit criterion was not fulfilled. In line with the Communication of 8 March 2023,[15] the Commission did not propose to open new excessive deficit procedures in spring 2023; in turn, the Commission stated that it would propose to the Council to open deficit-based excessive deficit procedures in spring 2024, on the basis of the outturn data for 2023. Estonia should take account of this in the execution of its 2023 budget and in preparing the Draft Budgetary Plan for 2024.

(14) The general government balance has been impacted by the fiscal policy measures adopted to mitigate the economic and social impact of the increase in energy prices. In 2022, such revenue-decreasing measures included lower excise for agricultural fuel; while such expenditure-increasing measures included a partial compensation of energy bills for households earning less than the median income, reduced network charges for electricity and gas for households and corporates, electricity and gas price caps for households, and a one-time 50-euro social transfer to pensioners and families with children. The Commission estimates the net budgetary cost of these measures at 0.8% of GDP in 2022. The general government balance has also been impacted by the budgetary cost of temporary protection to displaced persons from Ukraine, which is estimated at 0.6% of GDP in 2022. At the same time, the estimated cost of COVID-19 temporary emergency measures dropped to 0% of GDP in 2022, from 2.3% in 2021.

[12] SWD(2023) 630 final.
[13] Eurostat-Euro Indicators, 47/2023, 21.4.2023
[14] COM(2023) 631 final, 24.5.2023.
[15] COM(2023) 141 final, 8.3.2023.

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(15) On 18 June 2021, the Council recommended that in 2022 Estonia[16] maintain a supportive fiscal stance, including from the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.

(16) According to the Commission estimates, the fiscal stance[17] in 2022 was contractionary, at 1.3% of GDP, which was appropriate in a context of high inflation. As recommended by the Council, Estonia continued to support the recovery with investments financed by the Recovery and Resilience Facility. Expenditure financed by Recovery and Resilience Facility grants and other EU funds amounted to 1.4% of GDP in 2022 (1.6% of GDP in 2021). The decrease in expenditures financed by Recovery and Resilience Facility grants and other EU funds in 2022 was due to the rapid and unforeseen rise in construction prices . Nationally financed investment provided a contractionary contribution of 0.6 percentage points to the fiscal stance[18]. Estonia therefore did not preserve nationally financed investment, which is not in line with the Council recommendation. At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) provided a contractionary contribution of 0.8 percentage points to the fiscal stance. Estonia therefore sufficiently limited the growth in nationally financed current expenditure.

(17) The macroeconomic scenario underpinning the budgetary projections in the Stability Programme is cautious in 2023 and realistic thereafter. The government projects real GDP to decrease by 1.5% in 2023 and to grow by 3.0% in 2024. By comparison, the Commission 2023 spring forecast projects a lower real GDP contraction of 0.1% in 2023 and a similar growth of 3.0% in 2024. The difference in 2023 is mainly due to the Commission expecting more favourable private consumption developments, together with a slightly lower HICP inflation and higher wage growth projections.

(18) In its 2023 Stability Programme, the government expects that the general government deficit will increase to 4.3% of GDP in 2023. The increase in 2023 mainly reflects discretionary measures, such as additional spending on family benefits, pensions, defence and education and income tax reduction via adjusting tax brackets, as well as an assumed rise in expenditure by local governments. According to the Programme, the general government debt-to-GDP ratio is expected to increase from 18.4% at the end of 2022 to 20.2% at the end of 2023. The Commission 2023 spring forecast projects a government deficit of 3.1% of GDP for 2023. This is lower than the deficit projected in the Stability Programme, mainly due to the denominator effect from higher nominal GDP projection and higher estimated growth of tax bases and tax and non-tax revenues.

(19) The government balance in 2023 is expected to continue to be impacted by the measures adopted to mitigate the economic and social impact of the increase in energy prices. They consist of measures extended from 2022, in particular a compensation of

[16] Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Estonia, OJ C 304, 29.07.2021 p. 23.

[17] The fiscal stance is measured as the change in primary expenditure (net of discretionary revenue measures), excluding Covid-19 crisis-related temporary emergency measures but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to medium-term potential growth. For more details see Box 1 in the Fiscal Statistical Tables.

[18] The decline in investments reflects the delay of some projects due to the sharp rise in construction costs linked to the supply chain disruptions due to the war in Ukraine. At the same time, other nationally financed capital expenditure provided an expansionary contribution of 0.4 percentage points of GDP, reflecting the acquisition of gas and fuel reserves.

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a share of all households' heating, electricity and gas bills. The net budgetary cost of the support measures is projected in the Commission 2023 spring forecast at 0.3% of GDP in 2023[19]. The measures in 2023 do not appear targeted to the most vulnerable households or firms, and they do not fully preserve the price signal to reduce energy demand and increase energy efficiency. As a result, the amount of targeted support measures, to be taken into account in the assessment of compliance with the recommendation for 2023, is estimated in the Commission 2023 spring forecast at 0% of GDP in 2023 (compared to 0.1% of GDP in 2022). The budgetary cost of temporary protection to displaced persons from Ukraine is projected to increase by 0.1 pps. of GDP compared to 2022.

(20) On 12 July 2022, the Council recommended[20] that Estonia take action to ensure in 2023 that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance[21], taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Estonia should stand ready to adjust current spending to the evolving situation. Estonia was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds.

(21) In 2023, the fiscal stance is projected in the Commission 2023 spring forecast to be expansionary (-0.8% of GDP), in a context of high inflation. This follows a contractionary fiscal stance in 2022 (+1.3% of GDP). The growth in nationally financed primary current expenditure (net of discretionary revenue measures) in 2023 is projected to provide an expansionary contribution of 1.2% of GDP to the fiscal stance. This includes the reduced cost of the targeted support measures to households and firms most vulnerable to energy price hikes by 0.1% of GDP. This also includes higher costs to offer temporary protection to displaced persons from Ukraine (by 0.1% of GDP). The expansionary contribution of nationally financed net primary current expenditure is therefore not due to the targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. The expansionary growth in nationally financed primary current expenditure (net of discretionary revenue measures) is mainly driven by social spending, public wages, education and defence expenditure. In sum, the projected growth of nationally financed primary current expenditure is not in line with the recommendation of the Council. Expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to amount to 1.8% of GDP in 2023, while nationally financed investment is projected to provide a contractionary contribution to the fiscal stance of 0.3 percentage points. Therefore, Estonia plans to finance additional investment through the Recovery and Resilience Facility and other EU funds, and it is not projected to preserve nationally financed investment.[22] It plans to finance public investment for the green and digital transitions, and for energy security, such as energy efficiency of

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19 The figure represents the level of annual budgetary cost of those measures, including current revenue and expenditure as well as – where relevant – capital expenditure measures.

20 Council Recommendation of 12 July 2022 on the National Reform Programme of Estonia and delivering a Council opinion on the 2022 Stability Programme of Estonia, OJ C 334, 1.0.2022, p. 44.

21 Based on the Commission spring 2023 forecast, the medium-term (10-year average) potential output growth of Estonia, which is used to measure the fiscal stance, is estimated at 13.3% in nominal terms.

22 Other nationally financed capital expenditure is projected to provide a contractionary contribution of 0.3 percentage points of GDP, reflecting the base effect from 2022 when large gas reserves were aquired.

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housing, strengthening the electricity transmission networks to allow more green energy production, internet broadband, digital services, upskilling and retraining modules for green skills.

(22) According to the Stability Programme the general government deficit is expected to decline marginally to 4.2% of GDP in 2024. The decrease in 2024 mainly reflects a decrease in expenditure as a share of GDP. The programme expects the general government debt-to-GDP ratio to increase to 23.6% at the end of 2024. However, as the programme states, these projections do not yet include the planned fiscal consolidation measures of the new government that took office on 17 April 2023, because the measures are not yet specified in legal acts. The new government is planning to raise the value added tax, environmental taxes, excises on alcohol and tobacco and to institute a car tax. On the expenditure side, the government is planning to cut certain child benefits. Overall, the Stability Programme estimates that these measures would improve the budget balance by 1.3% of GDP in 2024. Based on policy measures known with sufficient detail at the cut-off date of the forecast (i.e. without the planned future measures mentioned above), the Commission 2023 spring forecast projects a government deficit for 2024 of 2.7% of GDP. This is lower than the deficit projected in the programme, mainly due to the lower deficit base projected for 2023 and a more favourable GDP and tax revenue outlook for 2024 in the Commission forecast. The Commission 2023 spring forecast likewise projects a lower general government debt-to-GDP ratio, of 21.3% at the end of 2024.

(23) The Stability Programme envisages the phasing out of all of the energy support measures in 2024. The Commission also assumes full phasing out of energy support measures in 2024. This hinges upon the assumption of no renewed energy price increases.

(24) Council Regulation (EC) No 1466/97 calls for an annual improvement in the structural budget balance toward the medium-term objective by 0.5% of GDP as a benchmark.[23] Taking into account fiscal sustainability considerations,[24] and the need to reduce the deficit to below the 3% of GDP reference value, an improvement in the structural balance of at least 0.3% of GDP for 2024 would be appropriate. To ensure such an improvement, the growth in net nationally financed primary expenditure[25] in 2024 should not exceed 4.9%, as reflected in this recommendation. This will also contribute to reducing core inflation, which is well above the euro area average, and which could lead to competitiveness losses if persistent. At the same time, the remaining energy support measures (currently estimated by the Commission at 0.3% of GDP in 2023) should be phased out, contingent on energy market developments and starting from the least targeted ones, and the related savings should be used to reduce the government deficit. However, according to the Commission 2023 spring forecast, the growth in net nationally financed primary current expenditure in 2023 is not in line with the

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[23] Cf. Article 5 of Council Regulation (EC) No 1466/97, which also requires an adjustment of more than 0.5% of GDP for Member States with a government debt exceeding 60% of GDP, or with more pronounced debt sustainability risks.

[24] The Commission estimated that Estonia would need an average annual increase in the structural primary balance as a share of GDP of 0.0 percentage points to achieve a plausible debt reduction or to ensure that government debt is kept at prudent levels in the medium term. This estimate was based on the Commission autumn 2022 forecast. The starting point for this estimate was the projected government deficit and debt for 2024 which assumed the withdrawal of energy support measures in 2024.

[25] Net primary expenditure is defined as nationally financed expenditure net of discretionary revenues measures and excluding interest expenditure as well as cyclical unemployment expenditure.

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recommendation of the Council. If this is confirmed, lower growth in net primary expenditure in 2024 would be appropriate.

(25) Assuming unchanged policies, the Commission 2023 spring forecast projects net nationally financed primary expenditure to grow at 4.5% in 2024, which is below the recommended rate.

(26) According to the programme, government investment is expected to remain at 5.3% of GDP in 2024 compared to an average of 5.3% of GDP in 2018-2023. In terms of funding sources, nationally financed investment is projected to decline and investment financed by the EU to increase, namely through the Recovery and Resilience Facility.

(27) The Stability Programme outlines a medium-term fiscal path until 2027. According to the programme, the general government deficit is expected to amount to 4.0% of GDP in 2025, 4.5% at 2026 and 4.2% by 2027. The general government deficit is therefore not planned to return to below 3% of GDP over the programme horizon. According to the Programme, the general government debt-to-GDP ratio is expected to increase from 23.6% at the end of 2024 to 33% by the end of 2027. However, as noted above, these projections do not yet include the new government's planned fiscal consolidation measures.

(28) Estonia submitted a revision of its plan together with REPowerEU chapter on 9 March 2023, which was adopted by the Commission on 12 May 2023 and is subject to the Council approval. Due to high inflation and disruptions in supply chains caused by the war in Ukraine, a few investments have been delayed or discontinued, which resulted in the revision of the initial plan. Estonia is the first Member State to have included the REPowerEU chapter in the revision of the plan and intends to submit the first and second payment request as soon as the revision has been approved by the Council. In accordance with Article 19(3), point (b) and Annex V, criterion 2.2 of Regulation (EU) 2021/241, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. The new REPowerEU chapter in the recovery and resilience plan allows additional reforms and investments to be financed in support of Estonia's strategic objectives in the field of energy and the green transition. The systematic and effective involvement of local and regional authorities, social partners and other relevant stakeholders remains important for the successful implementation of the recovery and resilience plan, as well as other economic and employment policies going beyond the plan, to ensure broad ownership of the overall policy agenda.

(29) The Commission approved all of Estonia's cohesion policy programming documents in 2022. Proceeding with the swift implementation of the cohesion policy programmes in complementarity andd synergy with the recovery and resilience plan, including the REPowerEU chapter, is key to achieving the green and digital transition, increasing economic and social resilience, as well as achieving balanced territorial development in Estonia.

(30) Beyond the economic and social challenges addressed by the recovery and resilience plan, Estonia faces a number of additional challenges related to the adequacy of the social safety net, particularly for the unemployed and older people, long-term care and healthcare and to energy and the green transition.

(31) The adequacy of the social safety net has improved, but the risk of poverty or social exclusion remains high among some groups, in particular older people (41.6% against 19.5% in the EU in 2021) and persons with disabilities (with 40.4% against 28.9% in

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the EU in 2021). For older people (65+) the risks of poverty or social exclusion are high largely due to the average pensionbeing low. In addition, a gender gap in poverty among older people persists (the at-risk-of-poverty rate for older women is 47.9%, almost 21 percentage points higher than for men). Restrictive criteria for receiving unemployment benefits, in particular the high thresholds for employment and income before unemployment, continue to expose unemployed people to the risk of falling into poverty. People with short work spells and in non-standard forms of work are not eligible for unemployment benefits when they become unemployed. In 2022, only 36% of the newly registered unemployed received unemployment benefits and 39% received the fixed unemployment allowance. Extending the coverage of unemployment benefits and relaxing the minimum criteria to access them, in particular for those with short work spells and in non-standard forms of work, and increasing the adequacy of pensions could help strengthen social protection.

(32) Estonia has taken steps to improve the accessibility and affordability of long-term care, but challenges remain. Public expenditure on healthcare and long-term care are low compared to the EU average, hampering timely and equal access to health and long-term care. A high proportion of the population aged 65 and over in need of long-term care has no help with personal care or household activities. The need for home care services is one of the highest in the EU. Furthermore, while the population is ageing and life expectancy in Estonia is one of the lowest in the EU, the rate of self-reported unmet needs for medical care is high, although it has fallen compared with previous years (13% in 2020 and 8.1% in 2021, compared to an EU average of 2%). This high rate is in particular linked to waiting lists and a shortage and uneven distribution of health workers in the country. Although out-of-pocket payments have fallen slightly, they are high both for healthcare and long-term care and far above the EU average. Ensuring sustainable funding of healthcare and long-term care could help address the challenges in these areas.

(33) Following Russia's invasion of Ukraine, Estonia has successfully abandoned imports of gas from Russia by redirecting energy imports through the liquified natural gas (LNG) terminal in Klaipėda, Lithuania and the LNG terminal in Inkoo, Finland. Estonia's consumption of natural gas has dropped by 36% in the period August 2022 - March 2023, compared with the average gas consumption over the same period in the preceding 5 years, beyond the 15% reduction target. Estonia could keep pursuing efforts to temporarily reduce gas demand until 31 March 2024[26].The share of oil shale in Estonia's energy mix remains significant, even if the country is making progress in the deployment of renewable energy. The share of renewable energy in gross final energy consumption grew from 30.1% in 2020 to 37.6% in 2021. The share of oil shale accounted for 58% of the energy mix in 2021, a decrease of 5 percentage points since 2018, but an increase of 2 percentage points since 2020. In the REPowerEU chapter of the recently revised recovery and resilience plan, Estonia has committed to reforms on permitting and the capacity building of local permitting authorities. These are expected to enable further progress towards the use of renewable energy. Insufficient grid capacity to accommodate more renewables continues to hamper further progress. Estonia also needs to continue its efforts to synchronise its electricity network with that of the rest of the EU in order to phase out its dependency on the BRELL power grid. Progress is being made, but the transition still needs to be completed. To that end, cooperation with Latvia and Lithuania is necessary. Energy

[26] Council Regulation (EU) 2022/1369 and Council Regulation (EU) 2023/706

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efficiency is key to Estonia's green transition. Increasing the energy efficiency of the economy, including of the building stock, will require more ambitious energy efficiency targets and an increase in smaller municipalities' renovation capacity by better targeting support measures. Estonia has focused on increasing the sustainability of its transport sector by adopting the 2021-2035 Transport and Mobility Development Plan, but more appropriate measures should be taken to accelarate the shift to a less polluting transport sector. Although Estonia invests in the electrification of the rail network, its implementation has not yet been assessed. A shift to sustainable transport also needs to happen in the area of private vehicles, where wider use of zero- and low-emission vehicles is needed. Relevant incentives such as environmental taxes, including an emission-based annual road vehicle tax, could help accelerate the shift towards less polluting transport options.

(34) Labour and skills shortages in sectors and occupations key for the green transition, including manufacturing, deployment and maintenance of net-zero technologies, are creating bottlenecks in the transition to a net-zero economy. High-quality education and training systems that respond to changing labour market needs and targeted upskilling and reskilling measures are key to reducing skills shortages and promoting labour inclusion and reallocation. To unlock untapped labour supply, these measures need to be accessible, in particular for individuals and in sectors and regions most affected by the green transition. In 2022, labour shortages were reported in Estonia for 68 occupations that require specific skills or knowledge for the green transition, including refuse sorters, civil engineering technicians and civil engineers. Furthermore, labour shortages were reported as a factor that limits production in industry and construction.

(35) In light of the Commission's assessment, the Council has examined the 2023 Stability Programme and its opinion[27] is reflected in recommendation (1) below.

(36) In view of the close interlinkages between the economies of euro area Member States and their collective contribution to the functioning of the Economic and Monetary Union, the Council recommended that euro area Member States take action, including through their recovery and resilience plans, to (i) preserve debt sustainability and refrain from broad-based support to aggregate demand in 2023, better target fiscal measures taken to mitigate the impact of high energy prices and reflect on appropriate ways to wind down support as energy price pressures diminish; (ii) sustain high public investment and promote private investment to support the green and digital transition; (iii) support wage developments that mitigate the loss in purchasing power while limiting second-round effects on inflation, further improve active labour market policies and address skills shortages; (iv) improve the business environment and ensure that energy support to companies is cost-effective, temporary, targeted to viable firms and that it maintains incentives for the green transition; and (v) preserve macro-financial stability and monitor risks while continuing to work on completing the Banking Union. For Estonia, recommendations (1), (2), (3) and (4) contribute to the implementation of the first, second and third euro area recommendations.

[27] Under Articles 5(2) and 9(2) of Council Regulation (EC) No 1466/97.

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HEREBY RECOMMENDS that Estonia take action in 2023 and 2024 to:

1. Wind down the energy support measures in force by the end of 2023, using the related savings to reduce the government deficit. Should renewed energy price increases necessitate support measures, ensure that these are targeted at protecting vulnerable households and firms, fiscally affordable, and preserve incentives for energy savings.

   Ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024 to not more than 4.9%.

   Preserve nationally financed public investment and ensure the effective absorption of RRF grants and other EU funds, in particular to foster the green and digital transitions.

   For the period beyond 2024, continue to pursue a medium-term fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to higher sustainable growth, to achieve a prudent medium-term fiscal position.

2. Proceed with the steady implementation of its recovery and resilience plan including its REPowerEU chapter. Proceed with the swift implementation of cohesion policy programmes, in close complementarity and synergy with the recovery and resilience plan.

3. Strengthen social protection, including to address old-age poverty, and by extending the coverage of unemployment benefits, in particular for those with short work spells and in non-standard forms of work. Improve access to and the affordability of healthcare and long-term care, in particular by ensuring their sustainable funding.

4. Reduce overall reliance on fossil fuels, accelerate the deployment of renewable energy sources, including by strengthening the domestic electricity grid capacity. Ensure sufficient capacity of electricity interconnections to increase the security of supply and continue the synchronisation with the EU electricity grid. Strengthen energy efficiency through new financing and support measures to meet the targets of the long-term renovation strategy. Continue efforts to increase the share of sustainable transport by electrifying the rail network and through taxation that incentivises the gradual renewal of the vehicle stock towards zero- or low-emission vehicles. Step up policy efforts aimed at the provision and acquisition of the skills needed for the green transition.

Done at Brussels,

For the Council
The President

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