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**NOTE**

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| From: | General Secretariat of the Council |
| To: | Permanent Representatives Committee/Council |
| Subject: | COUNCIL RECOMMENDATION on the economic, social, employment, structural and budgetary policies of Estonia |

Delegations will find attached the above-mentioned draft Council Recommendation, as revised and agreed by various Council committees and finalized by the Economic and Financial Committee, based on the Commission Proposal COM(2025) 206 final.

**COUNCIL RECOMMENDATION**

**on the economic, social, employment, structural and budgetary policies of Estonia**

THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97[1], and in particular Article 3(3) 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,

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1 OJ L, 2024/1263, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.
2 OJ L 306, 23.11.2011, p. 25, ELI: http://data.europa.eu/eli/reg/2011/1176/oj.

Whereas:

**General considerations**

(1) Regulation (EU) 2024/1263, which entered into force on 30 April 2024, specifies the objectives of the economic governance framework, which aims at promoting sound and sustainable public finances and sustainable and inclusive growth and resilience through reforms and investments, and preventing excessive government deficits. The Regulation stipulates that the Council and the Commission conduct multilateral surveillance in the context of the European Semester in accordance with the objectives and requirements set out in the TFEU. The European Semester includes, in particular, the formulation, and the surveillance of the implementation of country-specific recommendations. The Regulation also promotes national ownership of fiscal policy and emphasises its medium-term focus, combined with more effective and coherent enforcement. Each Member State must submit to the Council and the Commission a national medium-term fiscal-structural plan, containing its fiscal, reform and investment commitments, over 4 or 5 years, depending on the length of the national legislative term. The net expenditure[3] path in these plans has to comply with the Regulation's requirements, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period, or for it to remain at prudent levels below 60% of gross domestic product (GDP), and to bring and/or maintain the general government deficit below the 3%-of-GDP Treaty reference value over the medium term. Where a Member State commits to a relevant set of reforms and investments in accordance with the criteria set out in the Regulation, the adjustment period may be extended by up to three years.

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[3] Net expenditure as defined in Article 2, point (2), of Regulation (EU) 2024/1263: 'net expenditure' means government expenditure net of (i) interest expenditure; (ii) discretionary revenue measures; (iii) expenditure on programmes of the Union fully matched by revenue from Union funds; (iv) national expenditure on co-financing of programmes funded by the Union; (v) cyclical elements of unemployment benefit expenditure; and (vi) one-offs and other temporary measures.

(2) Regulation (EU) 2021/241 of the European Parliament and of the Council[4], which established the Recovery and Resilience Facility (the 'RRF'), entered into force on 19 February 2021. The RRF provides financial support to Member States for implementing reforms and investments, delivering a fiscal impulse financed by the Union. In line with the priorities of the European Semester for economic policy coordination, the RRF fosters economic and social recovery while driving sustainable reforms and investments, in particular promoting the green and digital transitions and making 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 Union and support the continued implementation of the European Pillar of Social Rights.

(3) Regulation (EU) 2023/435 of the European Parliament and of the Council[5] (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to phase out the Union's dependence on Russian fossil-fuel imports. This helps achieve energy security and diversify the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. Estonia added a new REPowerEU chapter to its national recovery and resilience plan in order to finance key reforms and investments that will help achieve the REPowerEU objectives.

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[4] 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, ELI: http://data.europa.eu/eli/reg/2021/241/oj).

[5] 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, ELI: http://data.europa.eu/eli/reg/2023/435/oj).

(4) 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 that Regulation, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines set out in Annex V. On 29 October 2021, the Council adopted its Implementing Decision approving the assessment of the recovery and resilience plan for Estonia[6], which was amended under Article 18(2) on 16 June 2023 to update the maximum financial contribution for non-repayable financial support, as well as to include the REPowerEU chapter[7]. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5), stating that Estonia has satisfactorily achieved the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory achievement requires that the achievement of preceding milestones and targets for the same reform or investment has not been reversed.

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6 Council Implementing Decision of 29 October 2021 on the approval of the assessment of the recovery and resilience plan for Estonia (0319/2021).

7 Council Implementing Decision of 16 June 2023 amending the Implementing Decision of 29 October 2021 on the approval of the assessment of the recovery and resilience plan for Estonia (ST 9367/2023).

(5) On 21 January 2025 the Council, upon the recommendation of the Commission, adopted a recommendation endorsing the national medium-term fiscal-structural plan of Estonia[8]. The plan was submitted in accordance with Articles 11 and 36(1), point (a) of Regulation (EU) 2024/1263, covers the period from 2025 until 2028 and presents a fiscal adjustment spread over four years.

(6) On 26 November 2024, the Commission adopted an opinion on the 2025 draft budgetary plan of Estonia. On the same date, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the 2025 Alert Mechanism Report, in which it identified Estonia as one of the Member States for which an in-depth review would be needed. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2025 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area[9] on 13 May 2025 and the Joint Employment Report on 10 March 2025.

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8 Council Recommendation of 21 January 2025 endorsing the medium-term fiscal-structural plan of Estonia, OJ C/2025/655, 10.02.2025.

9 Council Recommendation of 13 May 2025 on the economic policy of the euro area (OJ C, C/2025/2782, 22.5.2025, ELI: http://data.europa.eu/eli/C/2025/2782/oj).

(7) On 29 January 2025, the Commission published the Competitiveness Compass, a strategic framework that aims to boost the EU's global competitiveness over the next five years. It identifies the three transformative imperatives of sustainable economic growth: (i) innovation; (ii) decarbonisation and competitiveness; and (iii) security. To close the innovation gap, the EU aims to foster industrial innovation, support the growth of start-ups through initiatives like the EU Start-up and Scale-up Strategy, and promote the adoption of advanced technologies like artificial intelligence and quantum computing. In pursuit of a greener economy, the Commission has outlined a comprehensive Affordable Energy Action Plan and a Clean Industrial Deal, ensuring that the shift to clean energy remains cost-effective, competitiveness-friendly, particularly for energy-intensive sectors, and is a driver for growth. To reduce excessive dependencies and increase security, the Union is committed to strengthening global trade partnerships, diversifying supply chains and securing access to critical raw materials and clean energy sources. These priorities are underpinned by horizontal enablers, namely regulatory simplification, deepening of the single market, financing competitiveness and a Savings and Investments Union, promotion of skills and quality jobs, and better coordination of EU policies. The Competitiveness Compass is aligned with the European Semester, ensuring that Member States' economic policies are consistent with the Commission's strategic objectives, creating a unified approach to economic governance that fosters sustainable growth, innovation and resilience across the Union.

(8) In 2025, the European Semester for economic policy coordination continues to develop alongside the implementation of the RRF. The full implementation of the recovery and resilience plans remains essential for delivering on the policy priorities under the European Semester, as the plans help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations issued in recent years. These country-specific recommendations remain equally relevant for the assessment of amended recovery and resilience plans in accordance with Article 21 of Regulation (EU) 2021/241.

(9) The 2025 country-specific recommendations cover the key economic policy challenges that are not sufficiently addressed by measures included in the recovery and resilience plans, taking into account the relevant challenges identified in the 2019-2024 country-specific recommendations.

(10) On 4 June 2025, the Commission published the 2025 country report for Estonia. It assessed Estonia's progress in addressing the relevant country-specific recommendations and took stock of Estonia's implementation of the recovery and resilience plan. Based on this analysis, the country report identified the most pressing challenges Estonia is facing. It also assessed Estonia's progress in implementing the European Pillar of Social Rights and in achieving the Union's 2030 headline targets on employment, skills and poverty and social exclusion reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

(11) The Commission carried out an in-depth review under Article 5 of Regulation (EU) No 1176/2011 for Estonia. The main findings of the Commission's assessment of macroeconomic vulnerabilities for Estonia for the purposes of that Regulation were published on 13 May 2025[10]. On 4 June 2025, the Commission concluded that Estonia is not experiencing macroeconomic imbalances. In particular, vulnerabilities relating to deteriorating price and cost competitiveness have been present in recent years amid a protracted recession, and house prices have grown considerably, but overall vulnerabilities seem to be contained at present. Wages and prices have grown strongly for a number of years, and core inflation remained well above the euro area average in early 2025, driven by wage growth, especially in the public sector. These price and cost pressures are impairing the competitiveness position of the economy. While the loss of cheap energy and other inputs following Russia's war of aggression against Ukraine were the triggers for sustained price growth in 2022, inflationary pressure is now mostly domestic. Strong domestic demand and a tight labour market enabled wages to grow quickly at a time of weak productivity. Public wages, especially for teachers and health care staff, have increased over the last years, catching up from relatively low levels in the past. Part of the high inflation can be attributed to increases in indirect taxes. Estonian exports have lost some market shares in the past two years. The current account deficit has shrunk recently, owing to a recession at home; the net international investment position is only moderately negative and risks to external sustainability appear limited. House prices have grown considerably in recent years and are estimated to be overvalued, but the risk to financial stability associated with mortgage lending remains low. Some past policy actions have contributed to this situation, in particular by having fuelled domestic demand once the worst of the pandemic crisis was behind. These included the release of the second pillar pension funds, which boosted prices, including house prices. In recent years, the increase in public salaries and in minimum wages have coincided with the recession and led to higher overall wage growth across the economy. Measures to improve labour productivity and the business environment remain limited. The government recently announced several tax- and expenditure-reducing policy actions for 2026 that could lower inflationary pressures and alleviate some labour cost pressures.

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10 SWD(2025)123 final.

**Assessment of the Annual Progress Report**

(12) On 21 January 2025 the Council recommended the following maximum growth rates of net expenditure for Estonia: 7.1% in 2025, 5.1% in 2026, 3.6% in 2027, and 3.2% in 2028, which corresponds to the maximum cumulative growth rates calculated by reference to 2023 of 9.2% in 2025, 14.8% in 2026, 18.9% in 2027, and 22.6% in 2028.

(13) On 29 April 2025, Estonia submitted its Annual Progress Report[11], on adherence to the recommended maximum growth rates of net expenditure and the implementation of reforms and investments responding to the main challenges identified in the European Semester country-specific recommendations. The Annual Progress Report also reflects Estonia's biannual reporting on the progress made in achieving its recovery and resilience plan in accordance with Article 27 of Regulation (EU) 2021/241.

(14) Russia's war of aggression against Ukraine and its repercussions constitute an existential challenge for the European Union. The Commission recommended to activate the national escape clause (NEC) of the Stability and Growth Pact in a coordinated manner to support the EU efforts to achieve a rapid and significant increase in defence spending and this proposal was welcomed by the European Council of 6 March 2025. Following the request of Estonia on 29 April 2025, on [date; OJ: please insert here as date 8 July 2025] the Council, upon the recommendation of the Commission, adopted a recommendation allowing Estonia to deviate from, and exceed, the maximum growth rates of net expenditure[12].

11 The 2025 Annual Progress Reports are available on: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/annual-progress-reports_en.

12 Council Recommendation allowing Estonia to deviate from the maximum growth rates of net expenditure as set by the Council under Regulation (EU) 2024/1263 (Activation of the national escape clause), OJ [OJ: please insert in this footnote the reference and date of adoption of Council Recommendation contained in document ST 10467/25].

(15) Based on data validated by Eurostat[13], Estonia's general government deficit decreased from 3.1% of GDP in 2023 to 1.5% in 2024, while general government debt rose from 20.2% of GDP at the end of 2023 to 23.6% at the end of 2024. According to the Commission's calculations, these developments correspond to a net expenditure growth rate of 1.8% in 2024. In the Annual Progress Report, Estonia estimates the net expenditure growth in 2024 at 1.1%. The Commission estimates that the net expenditure growth was higher than in the Annual Progress Report. The difference between the Commission's calculations and the estimates of national authorities is due to a smaller Commission's estimate of the impact of discretionary revenue measures. Based on the Commission's estimates, the fiscal stance[14], which includes both nationally and EU financed expenditure, was contractionary, by 1.8% of GDP, in 2024.

(16) According to the Annual Progress Report, the macroeconomic scenario underpinning the budgetary projections by Estonia expects real GDP growth of 1.7% in 2025 and 2.5% in 2026, while HICP inflation is projected at 5.1% in 2025 and 4.3% in 2026. The Commission Spring 2025 Forecast projects real GDP to grow by 1.1% in 2025 and 2.3% in 2026, and HICP inflation to stand at 3.8% in 2025 and 2.3% in 2026.

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[13] Eurostat-Euro Indicators, 22.4.2025.

[14] The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the EU budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

(17) In the Annual Progress Report, the general government deficit is expected to remain at 1.5% of GDP in 2025, while the general government debt-to-GDP ratio is set to decrease to 22.5% by the end of 2025. These developments correspond to net expenditure growth of 1.0% in 2025. The Commission Spring 2025 Forecast projects a general government deficit of 1.4% of GDP in 2025. Increases in revenue, due to increased tax rates on personal and corporate income, income from credit institutions and value added, as well as from the introduction of a motor vehicle tax, are expected to more than offset the increase in government expenditure. The economic recovery is also set to improve the intake of these taxes. According to the Commission's calculations, these developments correspond to net expenditure growth of 2.1% in 2025. These higher projections of net expenditure growth than in the Annual Progress Report are also due to Commission assuming higher growth of current primary expenditure, lower expenditure funded by transfers from the EU and lower national co-financing of EU programmes. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be expansionary by 1.0% of GDP in 2025. According to the Commission Spring 2025 Forecast, the general government debt-to-GDP ratio is set to increase to 23.8% by the end of 2025. The increase of the debt-to-GDP ratio in 2025 mainly reflects the budget deficit as well as stock-flow adjustments.

(18) General government expenditure amounting to 0.6% of GDP is expected to be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2025, compared to 0.4% of GDP in 2024, according to the Commission Spring 2025 Forecast. Expenditure financed by Recovery and Resilience Facility non-repayable support enables high-quality investment and productivity-enhancing reforms, without a direct impact on the general government balance and debt of Estonia.

(19) General government defence expenditure in Estonia amounted to 2.0% of GDP in 2021, 2.2% of GDP in 2022 and 2.7% of GDP in 2023[15]. According to the Commission Spring 2025 Forecast, expenditure on defence is projected to amount to 3.4% of GDP in 2024 and 3.8% of GDP in 2025. This corresponds to an increase of 1.7 percentage points of GDP compared to 2021. Estonia estimates expenditure on defence at 3.4% of GDP in 2024 and at 3.7% of GDP in 2025. Estonia estimates expenditure on defence at 3.4% of GDP in 2024 and at 3.7% of GDP in 2025. The period when the national escape clause is activated (2025-2028) allows Estonia to reprioritise government expenditure or increase government revenue so that lastingly higher defence expenditure would not endanger fiscal sustainability in the medium term.

(20) According to the Commission Spring 2025 Forecast, net expenditure in Estonia is projected to grow by 2.1% in 2025 and 3.9% cumulatively in 2024 and 2025. Based on the Commission Spring 2025 Forecast, net expenditure growth of Estonia in 2025 is projected to be below the recommended maximum growth rate, both annually and when considering 2024 and 2025 together.

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[15] Eurostat, government expenditure by classification of functions of government (COFOG). Due to methodological differences between the COFOG and NATO definitions, expenditure based on the COFOG definition may differ from the expenditure based on the NATO definition.

(21) In the Annual Progress Report, the general government deficit is projected to increase to 2.5% of GDP in 2026, while the general government debt-to-GDP ratio is projected to increase to 24.0% by the end of 2026. The 2025 Annual Progress Report does not include budgetary projections beyond 2026. Based on policy measures known at the cut-off date of the forecast, the Commission Spring 2025 Forecast projects a government deficit of 2.4% of GDP in 2026. The projected increase in the deficit for 2026 is driven by the revenue side, due mainly to the application of a tax-free allowance to all taxpayers of personal income tax and lower tax intakes on dividend earnings, reflecting companies distributing high dividends in 2024 and 2025 in anticipation of the tax hike on corporate income tax. These developments correspond to net expenditure growth of 4.1% in 2026. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be expansionary, by 0.5% of GDP, in 2026. The general government debt-to-GDP ratio is projected by the Commission to increase to 25.4% by the end of 2026. The increase of the debt-to-GDP ratio in 2026 mainly reflects the projected government deficit.

**Key policy challenges**

(22) Although Estonia's tax revenue continued to increase as a share of GDP in 2024, it remains below the EU average. Closing that gap would make extra funding available for public expenditure priorities such as defence, healthcare and long-term care. Property taxes, which are among the taxes least detrimental to growth, have been about seven times lower than the EU average for the past years up to 2023, at just 0.3% of GDP. Over the same period, capital taxes have followed a similar trend, being three times lower than the EU average. In 2025, Estonia will raise the corporate income tax rate from 20% to 22% and abolish the reduced tax rate of 14% applied to regular dividends. These measures will increase the share of capital taxes in total revenues and help reduce the gap with the EU average. Conversely, Estonia relies mostly on taxes on labour and consumption, with revenue from these taxes above the EU average as a percentage of GDP. The share of these taxes in total revenues is set to increase following recent and planned rises in the value added tax rate. Although the tax increases will also help reduce the total tax revenue gap with the EU, they are regressive, with the tax burden being unevenly distributed. They can therefore exacerbate the already high income inequality and risk having an inflationary impact, with high inflation identified as a considerable challenge to Estonia's competitiveness. Estonia is also working on integrating regular spending reviews and policy evaluations into the medium-term budget planning. Implementing these reviews to prioritise key areas of spending would contribute to a more efficient allocation of public funds to help meet rising structural spending needs and reduce the pressure to increase tax revenue.

(23) Access to adequate and affordable healthcare and long-term care is not yet ensured. Reforms and increased investment in recent years have contributed to reducing the level of self-reported unmet needs for medical care from 12.5% in 2023 to 8.5% in 2024. However, unmet needs remain among the highest in the EU, due to long waiting times and the uneven quality and availability of healthcare services across the country. Public spending on long-term care and healthcare services remains low, well below the EU average, and workforce shortages and the reliance on municipal funding limit service provision. Low levels of public spending lead to high out-of-pocket payments for healthcare and long-term care. The care reform that entered into force in 2023 is the first major step in strengthening long-term care in Estonia, though its impact remains to be seen. To further reduce the unmet needs for medical care and out-of-pocket payments, it is crucial to ensure adequate financing for high-quality care provision, especially as population ageing is expected to increase demand. Strengthening home and community-based care, alongside assistive technologies, would also help improve service accessibility and effectiveness across the country.

(24) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. These are expected to help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations. Within this tight timeframe, finalising the effective implementation of the recovery and resilience plan including the REPowerEU chapter, is essential to boost Estonia's long-term competitiveness through the green and digital transitions, while ensuring social fairness. The Commission Communication NextGenerationEU – The road to 2026, adopted on 4 June 2025, clarifies the applicable timeline for the end of the Facility and provides guidance to Member States to maximise implementation by 31 August 2026, including on how to further streamline their RRPs, lays out key options to consider when revising them, and stresses the importance of careful joint planning ahead for the submission of the last payment requests in 2026. The systematic involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential in order to ensure broad ownership for the successful implementation of the recovery and resilience plan.

(25) The implementation of the cohesion policy programme, which encompasses support from the European Regional Development Fund (ERDF), the Just Transition Fund (JTF), the European Social Fund Plus (ESF+) and the Cohesion Fund (CF), has accelerated in Estonia. It is important to continue efforts to ensure the swift implementation of this programme, while maximising its impact on the ground. Estonia is already taking action under its cohesion policy programme to boost competitiveness and growth while enhancing social cohesion. At the same time, Estonia continues to face challenges, including those relating to economic and social resilience, including poverty and social exclusion, healthcare and long-term care, the labour market integration of disadvantaged groups, as well as skills and educational supply, energy transition and regional competitiveness, especially in eastern border regions. In accordance with Article 18 of Regulation (EU) 2021/1060, Estonia is required – as part of the mid-term review of the cohesion policy funds – to review its programme taking into account, among other things, the challenges identified in the 2024 country-specific recommendations. The Commission proposals adopted on 1 April 2025[16] extend the deadline for submitting an assessment of the outcome of the mid-term review beyond 31 March 2025. They also provide flexibilities to help speed up programme implementation and incentives for Member States to allocate cohesion policy resources to five strategic priority areas of the Union, namely competitiveness in strategic technologies, defence, housing, water resilience and energy transition, and to investments in skills in priority sectors while maintaining the focus on persons in most vulnerable situations in ESF+ programmes.

[16] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulations (EU) 2021/1058 and (EU) 2021/1056 as regards specific measures to address strategic challenges in the context of the mid-term review − COM(2025) 123 final.

(26) The Strategic Technologies for Europe Platform (STEP) provides the opportunity to invest in a key EU strategic priority by strengthening the EU's competitiveness. STEP is channelled through 11 existing EU funds. Member States can also contribute to the InvestEU programme supporting investments in priority areas. Estonia could make optimal use of these initiatives to support the development or manufacturing of critical technologies, including clean and resource-efficient technologies.

(27) Beyond the economic and social challenges addressed by the recovery and resilience plan and other EU funds, Estonia should effectively address the remaining challenges related to research and innovation policy, access to financing, labour productivity and skills supply, social protection, renewable energy and energy efficiency, and decarbonisation including in the transport sector.

(28) Although Estonia's overall innovation performance has steadily improved since 2017, business research and development (R&D) spending as a percentage of GDP remains below the EU average, with the information and communications technology sector accounting for nearly half of total R&D spending. Concurrently, the number of patent applications filed under the Patent Cooperation Treaty per EUR 1 billion of GDP has declined, suggesting that the public science base does not translate well into technological performance and business innovation. While direct public support for business R&D has increased, policies beyond grant schemes are underdeveloped, hindering Estonia's ability to address the needs of companies with limited ability to apply research discoveries. In addition, the share of applied research in total R&D financing fell to 23% in 2023. The Applied Research Centre was launched in 2024 and it will take time to develop a fully functional research technology organisation. There is a lack of close collaboration between business and academia. There is scope to strengthen the role of universities and applied research organisations in innovation to accelerate the take up of new technologies and to boost competitiveness.

(29) Access to finance for small and medium-sized enterprises (SMEs) in Estonia is more heavily constrained than on average in the EU. This undermines investment in innovation, especially in remote regions where regional shortages of skills and resources make innovative investment financing particularly risky. Estonian companies have a high need of investment to promote the digital and green transition and yet draw less on funding from capital markets than the EU average, relying instead more on investment funded internally. This is encouraged by the income tax system, the prevalence of SMEs and a modest institutional investor base. Promoting institutional investor participation in the equity market and encouraging the development of a self-sustained venture capital market could help attract investors.

(30) Recently, the shortage of labour has become less acute, but the lack of skilled workers remains the major obstacle to investment for 32% of businesses and skills mismatches occur in many sectors. Continuing investment in the green transition has increased and will further increase the demand for workers with specialised skills. This shortage of skills has coincided with rapid wage growth and a higher unit labour cost, limiting business productivity growth. In recent years, rapid wage growth has been one of the factors fuelling inflation and weighing on competitiveness. Relatively high rates both of early school leaving and drop out in higher education result in an insufficient number of skilled graduates, adding to the problem. The skills shortage is particularly acute at regional level, as rural and remote areas face more difficulties in attracting qualified professionals and have greater needs for reskilling and upskilling due to transition challenges. Skills mismatches could be limited by improving the job market relevance of the education and training system, notably for specialists in science, technology, engineering and mathematics. Policies could also improve access to reskilling and upskilling, notably for individuals with a low level of education, and also for older workers, including policies to improve basic digital skills. To support economic diversification to high value-added activities, greater use could be made of the OSKA system to anticipate demand for skills and simpler rules could be brought in to hire foreign skilled workers in shortage areas and help boost competitiveness.

(31) Estonia is making notable progress towards meeting the 2030 EU energy efficiency targets. By better targeting energy-efficient renovation schemes to vulnerable households and increasing support for the residential sector under new schemes to complement existing schemes (such as the RRF and the Apartment Building Reconstruction grant), Estonia could better meet the goals of its long-term renovation strategy and contribute to achieve the target to reduce emissions under the Effort Sharing Regulation. Currently, the country primarily draws on grant-based funding for energy efficiency improvements, with limited use of financial instruments. Estonia would benefit from more targeted schemes and from making broader use of financial instruments to achieve the EU energy efficiency targets.

(32) Although Estonia's energy mix saw a notable shift towards renewables (from 27.7% in 2022 to 34.6% in 2023), the energy mix still has a significant share of oil shale (58.2% in 2023), which hinders the green transition. Electricity prices remain high and volatile in Estonia due to the intermittent nature of renewable energy, driving up inflation and lowering competitiveness of businesses. Estonia also faces energy security issues due to hybrid attacks on pipelines and submarine cables in the Baltic Sea. Increasing the roll-out of renewable energy production (34.6% of the energy mix in 2023) and energy storage would help the ongoing and gradual phase-out of fossil fuels while maintaining a high degree of energy independence. After the successful synchronisation with the continental European electricity grid in 2025, additional action is needed to improve grid resilience and flexibility. Continuing work to strengthen the protection of critical energy infrastructure is also crucial, in particular in the area of cybersecurity and infrastructure surveillance.

(33) Estonia has one of the lowest resource productivity rates in the EU, which can be partially attributed to the country's resource-intensive oil shale industry and to the overall resource-intensive industrial system. In 2023, Estonia generated only EUR 0.63 per kg of material used, against the EU average of EUR 2.22. This has a negative impact on Estonia's competitiveness. Boosting eco-innovation and bio-based innovation to make sustainable use of natural resources could help improve Estonia's resource productivity and competitiveness. At 33%, Estonia's rate of preparing for reuse and recycling of municipal waste is significantly below the EU average of 49%. The country could benefit from bringing in new policy instruments to speed up the transition to a circular economy.

(34) Estonia's transport sector is a large greenhouse gas emission producer under the Effort Sharing Regulation, accounting for about 15% of the country's total emissions, 90% of which come from road transport. Railways are crucial for shifting transport from road to rail to improve sustainable mobility, but just 12% of the rail network is electrified compared to the EU average of 57% (2022). Estonia could therefore benefit from continuing action to electrify the rail network further to reduce its dependence on fossil fuels. Meanwhile, the car ownership rate is one of the EU's highest. In 2023, 75.5% of cars were petrol-powered and their average age is high. Only 6.3% of new vehicles in 2023 were electric, against the EU average of 14.5%. Estonia recently brought in vehicle taxes for private passenger cars based on weight and $CO_2$ emissions but the tax rates are lower for older vehicles. Although lower rates help protect vulnerable groups, Estonia could consider increasing the incentives to renew the stock of private road vehicles. Estonia is rightly considering raising the share of sustainable buses in the whole public bus fleet to 42% from the current 30% to provide green public transport in rural areas, thereby helping to renew the stock of public vehicles. Even though Estonia has integrated some local transport ticketing and planning systems with positive results, further action is needed on this front.

(35) Due to gaps in social protection, Estonia continues to face challenges related to poverty, social exclusion and persistent income inequality, despite recent improvements. Although the increases in pensions and child benefits have improved some social indicators, the risk of poverty and social exclusion rate remained high in 2024, especially among older people - in particular people aged 65 and over living alone - persons with disabilities and single-person households. Spending on social protection benefits is among the lowest in the EU at 15.4% of GDP in 2023, against 26.8% for the EU as a whole. The impact of social benefits (excluding pensions) on poverty also remains well below the EU average. Improving the adequacy and efficiency of the benefits system could help reduce the risk of poverty, as well as targeting support towards vulnerable groups such as persons with disabilities, single-person households and older people. Despite recent pension increases, driven mostly by inflation adjustments and rising social tax contributions, pensions remain among the lowest in the EU relative to wages, contributing to high old-age poverty. In-work poverty remains relatively high, particularly for people in non-standard forms of work, and is aggravated by relatively low minimum wages, despite recent increases. Estonia could extend the coverage of unemployment benefits to people who are not yet covered, such as people in non-standard forms of work, including self-employed. This could lower their risk of poverty. Regional disparities remain pronounced, with rural areas and eastern border regions at greater risk of poverty. Addressing these challenges would also contribute to supporting upward social convergence, in line with the Commission services' second-stage country analysis of the Social Convergence Framework[17].

[17] SWD(2025)95 – Second-stage country analysis on social convergence in line with the Social Convergence Framework (SCF), 2025.

(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, in 2025, the Council recommended that the euro-area Member States take action, including through their recovery and resilience plans, to implement the 2025 Recommendation on the economic policy of the euro area. For Estonia, recommendations (2), (3) and (4) help implement the first euro-area recommendation on competitiveness, while recommendations (4), (5) and (6) help implement the second euro-area recommendation on resilience, and recommendation (1) helps implement the third euro-area recommendation on macro-economic and financial stability set out in the 2025 Recommendation.

HEREBY RECOMMENDS that Estonia take action in 2025 and 2026 to:

1. Reinforce overall defence and security spending and readiness while ensuring debt sustainability in line with the European Council conclusions of 6 March 2025. Adhere to the maximum growth rates of net expenditure recommended by the Council on 21 January 2025, while making use of the allowance under the national escape clause for higher defence expenditure. Broaden the tax base by tapping into taxes that are less detrimental to growth. Ensure sustainable financing for spending needs including defence, and healthcare and long-term care to improve accessibility and affordability, while safeguarding against inflationary pressure.

2. In view of the applicable deadlines for the timely completion of reforms and investments under Regulation (EU) 2021/241, ensure the effective implementation of the recovery and resilience plan, including the REPowerEU chapter. Accelerate the implementation of the cohesion policy programme (ERDF, JTF, ESF+, CF), building, where appropriate, on the opportunities offered by the mid-term review. Make optimal use of EU instruments, including the opportunities provided by the InvestEU programme and the Strategic Technologies for Europe Platform, to improve competitiveness.

3. Focus investment on research and innovation by prioritising funding for applied research. Improve access to finance, especially for small and medium-sized enterprises and companies in remote regions, to facilitate innovative investment, for example investment in the green and digital transitions, including by promoting institutional investor participation in the venture capital and equity market.

4. Improve energy efficiency by taking new financing and support measures to meet the targets of the long-term renovation strategy. Reduce overall reliance on fossil fuels and the share of oil shale in the energy mix by investing in renewable energy and by promoting energy storage. Increase energy security, for example by ensuring the sufficient capacity of electricity interconnections. Raise resource productivity through bio-based innovation. Take further action to increase the availability and use of sustainable and less polluting transport, including by electrification of the rail network, renewal of the stock of road vehicles, and integration of public transport systems.

5. Improve labour productivity and skills supply through action on reskilling and upskilling, by reducing early school leaving, by improving the job market relevance of the education and training system, in particular by meeting the growing demand for specialists in science, technology, engineering and mathematics, and by better attracting and retaining talent. Step up policy measures aimed at the provision and acquisition of skills and competences needed for the green transition. Reduce the risk of poverty by strengthening social protection for older people, single-person households and people with disabilities by increasing the adequacy and efficiency of the benefit system, and for the unemployed, inter alia by extending the coverage of unemployment benefits, in particular to those in non-standard forms of work, while maintaining fiscal sustainability.

Done at Brussels,

*For the Council*
*The President*