Rahandusministeerium

MINISTRY of FINANCE of the REPUBLIC of ESTONIA

2023 Draft Budgetary Plan of Estonia

Tallinn, 14. October 2022

Table of Contents

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 between the euro area member states and ensures that the recommendations of the Council and of the Commission are taken into account accordingly in the budgetary processes of the member states. The information provided in the DBP should allow identifying possible discrepancies of the budgetary strategy from the one presented in the last Stability Programme.

The 2022 Stability Programme was approved by the Government on 28 April 2022. **The draft 2023 State Budget with explanatory memorandum was approved on 29 September in the meeting of the Government and it was given for proceeding to Parliament.**

The draft 2023 State Budget of the Republic of Estonia is based on State Budget Strategy 2023–2026, The Government's Action Programme and the planned activities take into account the Government's Action Programme and The European Commission and the Country Specific Recommendations as adopted by the Council in July. In the formulation of the fiscal policy, national requirements and the Stability and Growth Pact requirements on the budgetary policy of the EU Member States are being respected, taking into account the application of the General Escape Clause also for the year 2023.

1. Macroeconomic forecast

The Draft 2023 State Budget of the Republic of Estonia is based on the summer forecast of the Ministry of Finance (MoF), published on 23 August 2022. Assumptions of the forecast were fixed in mid-August 2022. Economic forecasts of the Ministry of Finance are public and can be found from the web page of the ministry (https://www.rahandusministeerium.ee/et/riigieelarve-ja-majandus/majandusprognoosid).

***

Until recently Estonia has shown good economic performance – wage growth has been in double digits, employment has been rising and both consumption and exports strong. At the same time, economic sentiment has been deteriorating for almost a year now and has fallen to the territory, where moderate decline in GDP is very probable.

Despite the positive effect of inflation on wage dynamics, the purchasing power of households is expected to decrease significantly in 2022. This is the price of war. However, the setback in labour market is expected to remain moderate – employment growth is forecast to decelerate from 3% in 2022 to below 1% in the following years, partly due to the positive effect as Ukrainian war refugees enter Estonian labour market. The 11% wage increase in 2022 is expected to decelerate to 7% in 2023 and remain around 4-5% thereafter.

Consumer price inflation is expected to peak in autumn. In spring 2023, inflation will slow down to one-digit level and will get marginal in the end of the year. This will hold under the assumptions that energy prices according to the futures will be declining starting from spring and that there will be no negative surprises in energy supply.

Private consumption will stay at the level of 2021 in 2022 in aggregate, but not all households can afford to consume non-compulsory goods and services as usual after paying for food, housing ang personal transportation. In 2023, average wage growth is expected to resume in real terms and average pension rise will be 18%, so private consumption should grow again somewhat.

Investment decline in 2022 is related to one-off factors, but rapid increase in construction prices also inhibits real investment for both private and public sectors. Raising interest rates should have limited impact to investors, while the need for energy efficiency and more production capacity will give pressure to capital investment for a long time. Investment in housing is supported by rising prices at least so far.

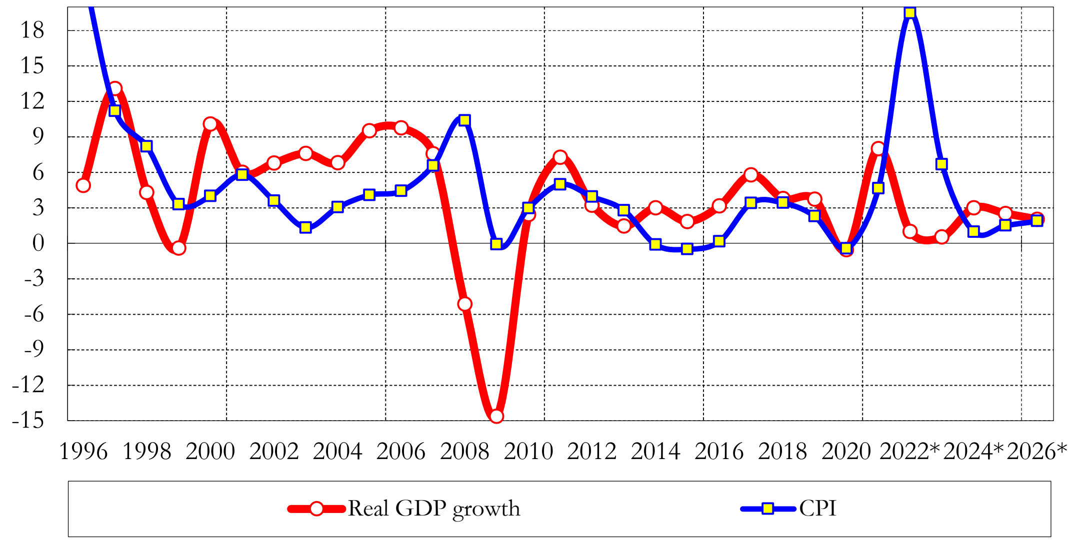
Driven by foreign demand, exports has showed strong performance so far. However, the growth of exports will slow down markedly in near term, relying more on services sector. Estonian exports of goods to Russia is declining and this trend will continue in the second half of the year.

All in all, economic activity in Estonia is expected to calm down in the second half of 2022 and we will see a couple of quarters with negative growth rates, both y.o.y. and q.o.q terms. Growth rates for 2022 and 2023 calendar years should still remain slightly positive, as recovery is expected to start in the middle of 2023.

Figure 1

Estonia's economic growth and the change of consumer price index

(per cent)

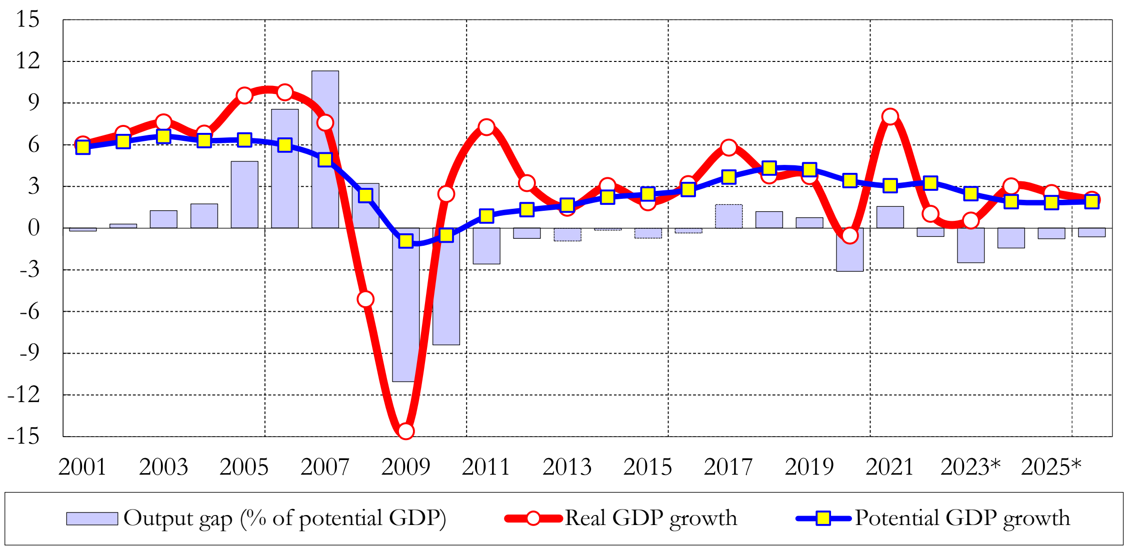


Source: Statistics Estonia, Ministry of Finance.

Figure 2

Development of potential GDP and output gap

(per cent)



Source: Statistics Estonia, Ministry of Finance.

Table 0.i) Basic assumptions

	2021	2022*	2023*
Short-term interest rate (annual average)	-0.5	0.3	1.4
Long-term interest rate (annual average)	-0.4	1.0	1.7
USD/€ exchange rate (annual average)	0.846	0.948	0.981
Nominal effective exchange rate	0.5	-2.0	-0.9
World excluding EU, GDP growth	5.9	3.0	3.0
Eurozone GDP growth	5.4	2.8	1.2
Growth of relevant foreign markets	9.5	2.6	1.8
World import volumes, excluding EU	12.1	4.0	3.3
Oil prices (Brent, USD/barrel)	70.8	103.7	88.1

Source: Ministry of Finance.

Table 1.a. Macroeconomic prospects

		2021 Level	2021 rate of change	2022 rate of change	2023 rate of change
1. Real GDP	B1*g	26039.3	1.0	0.5	3.0
of which					
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth (1/)		–	–	–	–
2. Potential GDP			3.0	3.2	2.5
contributions:					
- labour			0.7	1.4	0.8
- capital			1.2	1.2	1.2
- total factor productivity			1.1	0.6	0.5
3. Nominal GDP	B1*g	31444.9	16.0	5.8	4.6
Components of real GDP					
4. Private final consumption expenditure	P.3	12611.9	6.5	0.4	1.4
5. Government final consumption expenditure	P.3	4701.4	4.0	-1.5	-1.2
6. Gross fixed capital formation	P.51	8250.0	2.8	-12.5	3.7
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	487.3	1.5	3.2	1.2
8. Exports of goods and services	P.6	21778.2	19.9	3.0	1.6
9. Imports of goods and services	P.7	22446.8	21.0	-0.6	0.3
Contributions to real GDP growth					
10. Final domestic demand		26045.2	4.8	-3.6	1.5
11. Changes in inventories and net acquisition of valuables	P.52 + P.53	487.3	1.5	1.8	-2.1
12. External balance of goods and services	B.11	-668.6	-0.7	2.6	1.0

1/ Implementation of budgetary measures were decided after the completion of macroeconomic forecast and therefore their impact on economic growth is not included in the baseline forecast. See Table 1.e. for macroeconomic effect of fiscal policy measures in 2023 DBP and 2023-2026 State Budget Strategy.

Source: Statistics Estonia, Ministry of Finance.

Table 1.b. Price developments

	ESA code	2021	2021	2022*	2023*
		level 2010=100	rate of change	rate of change	rate of change
1. GDP deflator		120,8	6,0	14,8	5,2
2. Private consumption deflator		115,9	4,2	17,4	5,5
3. HICP		114,7	4,5	19,5	6,7
4. Public consumption deflator		132,5	5,1	12,2	4,4
5. Investment deflator		110,0	3,1	19,9	5,2
6. Export price deflator (goods and services)		113,1	7,9	15,7	3,9
7. Import price deflator (goods and services)		110,2	7,6	16,8	3,8

Source: Statistics Estonia, Ministry of Finance.

Table 1.c. Labour market developments

	ESA code	2021	2021	2022*	2023*
		Level	*rate of change*	*rate of change*	*rate of change*
1. Employment, persons		650,5	-0.5	2.9	0.5
2. Employment, hours worked			-0.5	2.9	0.5
3. Unemployment rate (%)		43.1	6,2	6,0	6,4
4. Labour productivity, (real GDP per employed person)		40,0	8,6	-1,8	0,1
5. Labour productivity, hours worked			8,6	-1,8	0,1
6. Compensation of employees	D.1	15300,7	9,6	14,1	7,7
7. Compensation per employee		23,5	10,1	11,0	7,1

Source: Statistics Estonia, Ministry of Finance.

Table 1.d. Sectoral balances

	ESA code	2021	2022*	2023*
		% of GDP	*% of GDP*	*% of GDP*
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	7.3	3.0	3.0
of which:				
- balance on goods and services		0.2	1.7	1.4
- balance of primary incomes and secondary incomes		-1.8	-0.2	-0.3
- capital account		8.9	1.5	1.9
2. Net lending/net borrowing of the private sector	B.9			
3. Net lending/net borrowing of general government	B.9	-5.0	-3.3	-2.2
4. Statistical discrepancy		-1.1	-	-

Source: Statistics Estonia, Ministry of Finance.

***

Economic forecast of the Ministry of Finance is prepared by analysts from the Fiscal Policy Department, who belong to the personnel of the Ministry. The objectivity and independence of the forecast is assured through the transparency of forecasting process, the involvement of different external economists and through continuous comparison of forecasting results. A preliminary version of the forecast will be discussed with the forecasting team of Bank of

Estonia. Before finalisation of the forecast of the Ministry of Finance, its main assumptions and results will be discussed in a joint seminar with different forecasters in Estonia, who belong to the central bank, commercial banks and other institutions dealing with economic analysis. There are approximately ten 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 systemic inducement by some forecasters.

The opinion of the Fiscal Council on the summer 2022 macroeconomic forecast of the Ministry of Finance

Pursuant to §18 of the State Budget Act, the Fiscal Council issued opinion on the summer 2022 economic forecast of the Ministry of Finance on 6 September and on 27 September opinion about the additional macroeconomic scenario and the fiscal targets set for 2023-2026.[1]

In its September 6 opinion, the Fiscal Council did not endorse the Summer Economic Forecast 2022 of the Ministry of Finance of Estonia as by the opinion of the fiscal Council it was found to use out-of-date assumptions about the growth of government spending. Since the Ministry of Finance did not agree with the opinion of the Fiscal Council, the Ministry of Finance responded to the Fiscal Council publicly on September 9.[2] Partially accepting the recommendations of the Fiscal Council, the Ministry of Finance prepared an additional macroeconomic scenario by September 23 (published on 27 September as part of explanatory letter of 2023 State Budget and the 2023-2026 State Budget Strategy). On the basis of this additional scenario, the Fiscal Council endorsed the new macroeconomic scenario of the Ministry of Finance on September 27, considering it an important input for the further discussion about the State Budget and State Budget Strategy.

Additional scenario to macroeconomic forecast taking into account impacts of fiscal policy decisions

The additional scenario to the 2022 summer macroeconomic forecast was prepared to estimate how the fiscal policy decisions made by the Estonian Government in the autumn 2022 may affect economic developments. The additional scenario is also a response to the recommendation of the Fiscal Council as it entails the most recent government expenditure assumptions.

However, this scenario remains as a technical update to the 2022 summer macroeconomic forecast. Firstly, the scenario does not carry additional information about external environment and general macroeconomic conditions for the private sector, which would be relevant in setting fiscal targets of the Government. Secondly, when agreeing on new fiscal measures, indirect effects of the decisions on the economy were already taken into account. Therefore, the 2022 summer macroeconomic forecast published on 23 August is still the baseline forecast for 2023 Draft Budgetary Plan of Estonia.

The scenario relies on the summer forecast, and it was simulated how the fiscal policy decisions

[1] More detailed analyses can be found on the web page of the Fiscal Council:

https://eelarvenoukogu.ee/news/the-fiscal-council-does-not-endorse-the-summer-economic-forecast-of-the-ministry-of-finance

https://eelarvenoukogu.ee/news/the-fiscal-council-finds-the-government-should-start-to-reduce-the-budget-deficit-from-2024

[2] Full report of Ministry of Finance can be found here: https://fin.ee/uudised/rahandusministeeriumi-vastus-eelarvenoukogu-arvamusele-2022-aasta-suvise-0

made during the preparation of the Draft 2023 State Budget and the State Budget Strategy for 2023-2026 could affect the development of different economic indicators. In other respects, all other assumptions are the same as in the summer forecast.

The decisions of the government increase significantly domestic demand in the following four years. In addition to wage increases in the public sector, family support measures are increased, income tax burden is lowered, and state's other expenditures and investments are increased, also in the field of defence. In 2023, extraordinary crisis expenditures are also planned for supporting war refugees and expenditures that may arise in relation to the need of limiting the spread of the coronavirus. In addition to that, the government applies price increase compensation measures to households and micro and small enterprises that limit their costs related to increases in energy prices.

According to the additional scenario, the government directs into the economy additionally about 1 billion euros. Due to openness of the Estonian economy, the extra demand will not completely transform into local value added, but a relatively large share of it will go out of the Estonian economy through imports. It can be assumed that the import content of the additional consumption expenditure is larger than that of consumption expenditures on average. Therefore, in comparison to the summer forecast, imports increase and the current account surplus decreases. The summer forecast expected the surplus of the current account to increase to above 2% of GDP, but in contrast, according to the additional scenario the current account surplus declines in the next year.

The additional expenditures of the government sector also give a push to the economic activity in Estonia. This accelerates the GDP growth rate in 2023 by 0.5 percentage points. Since according to the plans the stimulus from the government sector is larger in 2023 than in the following years, the GDP growth rates are slightly slower in 2024 and 2025, compared to the summer forecast. The nominal and real volumes of GDP are still higher throughout the forecast horizon in the scenario.

Energy price increase compensation measures lower the growth in consumer prices by 0.7 percentage points this year and by 0.3 percentage points next year. The estimated impact on inflation can still change because the price of electricity universal service was not known at the time when the additional scenario was compiled. The additional increase in household incomes lifts consumption and to some extent also domestic inflation.

Table 1.e. Macroeconomic scenario with the impact of DBP 2023 and Budget Strategy 2023-2026 measures

	2021	2022*	2023*	2024*	2022*	2023*	2024*
	Policy scenario				Difference from baseline		
1. Real GDP growth	8.0	1.0	1.0	2.8	0.0	0.5	-0.2
2. Nominal GDP growth	14.5	16.0	7.5	3.9	0.0	1.7	-0.7
3. CPI	4.6	18.8	6.4	1.4	-0.7	-0.3	0.4
4. Average wage	1 548	1 719	1 891	1 986	0	46	50
5. Real wage growth	2.1	-6.5	3.4	3.6	0.6	2.7	-0.3
6. Nominal wage growth	6.8	11.0	10.0	5.1	0.0	2.6	0.1
7. Current account (% of GDP)	-1.6	1.5	1.1	1.4	0.0	-1.4	-1.3
Contribution to growth							
8. Domestic demand	6.3	-1.7	0.8	2.6	0.0	1.3	-0.2
9. Net export	-0.7	2.6	0.2	0.2	0.0	-0.8	0.0
General government (% of GDP)							
10. Nominal budget balance	-2.3	-2.7	-3.8	-3.3	0.0	-1.8	-1.6
11. Structural balance	-4.0	-2.6	-2.6	-2.6	0.0	-1.8	-1.6

Source: Statistics Estonia, Ministry of Finance.

***

In the following, there are pointed out most relevant differences between Ministry of Finance's 2022 summer forecast and other institutions latest public macroeconomic forecasts. Comparing them, one should keep in mind that forecasts are compiled in different periods and are therefore based on different information, which causes variations in assumptions and results of the forecasts.

After the Russia's military invasion in Ukraine the growth forecasts have been revised downwards and inflation forecasts significantly revised upside. During the last months GDP expectations for 2022 have been between -0,5%...+1,7%. It can be noted that more pessimistic forecasts have taken account Q2 data for GDP. The economic forecast of the Ministry of Finance is in the middle of the forecasts range.

For 2023, the variability of forecasts by the institutions tends to be quite similar. GDP growth forecasts for 2022 are between 0,5% ... 1,8% and the tendency is lowering the forecasts by different institutions. The same applies to the summer forecast of the Ministry of Finance, where growth expectations have been cut to 0,5%, being in the lower side of the forecast range.

Table 1.f. Comparison of economic forecasts

	Real GDP growth, %			**Nominal GDP growth, %**		
	2022*	**2023***	**2024***	**2022***	**2023***	**2024***
Ministry of Finance	1.0	0.5	3.0	16.0	5.8	4.6
Bank of Estonia	-0.5	1.1	3.7	13.7**	4.5**	5.7**
Swedbank	1.7	0.5	2.5	-	-	-
SEB	1.2	0.5	3.5	-	-	-
Consensus Forecasts	1.2	1.2	-	-	-	-
European Commission	1.6	1.9	-	-	-	-
IMF	1.0	1.8	3.8	17.5	9.7	6.5
OECD	1.3	1.8		7.8**	4.6**	-
Estonian Institute of Economic Research	0.5	1.5		-	-	-

	Consumer Price Index, % (in brackets Harmonised Consumer Price Index)			**General government position, % of GDP**		
	2022*	**2023***	**2024***	**2022***	**2023***	**2024***
Ministry of Finance	19.5 (19.5*)	6.7 (6.7*)	1.0 (1.0*)	-2.7	-3.9	-3.3
Bank of Estonia	19.1 (19.2*)	6.8 (7.1*)	2.1 (2.1*)	-2.9	-4.2	-3.6
Swedbank	18.5	7.1	2.0	-2.2	-2.5	-1.9
SEB	18.2*	6.0*	2.5*	-3.5	-3.0	-2.5
Consensus Forecasts	18.7	8.9	-	-3.1	-2.6	-
European Commission	17.0*	4.7*		-	-	-
IMF	21.0*	9.5*	2.5*	-2.9	-2.3	-1.7
OECD	14.5*	10.9*		1.0	2.3	
Estonian Institute of Economic Research	18.0	6.5	-	-	-	-

* Harmonised Consumer Price Index.
** calculated from the forecast of nominal GDP volume or by summing up real GDP and GDP deflator.

Sources:
Ministry of Finance. 2022 Draft Budgetary Plan of Estonia. 15.10.2022.
European Commission. European Economic Forecast. Summer 2022. 14.07.2022.
IMF. World Economic Outlook. October 2022. 12.10.2022.
OECD Economic Outlook. No 111. June 2022. 08.06.2022.
Bank of Estonia. Monetary policy and economy. 3/2022. 20.09.2022.

Estonian Institute of Economic Research. Konjunktuur no 3 (222) 2022. 11.10.2022.
SEB. Nordic Outlook. August 2022. 30.08.2022.
Swedbank. Swedbank Economic Outlook – August 2022. 24.08.2022.
Eastern Europe Consensus Forecasts. 19.09.2022.

2. Budgetary targets

The Government's medium-term objective (MTO) is the general government structural deficit up to 0.5% of GDP according to the Stability Programme.

In 2022, the structurally adjusted budgetary position of general government is projected to be in a deficit of 2.6% of GDP. The general escape clause of the Stability and Growth Pact that was activated for years 2020 to 2022 due to the corona crisis, has been extended due to the Russian aggression against the State of Ukraine. The general escape clause allows a Member State of the European Union to deviate from the medium-term budgetary objective (MTO) or from its path towards the MTO. At the same time, the requirement still applies on the excessive budget deficit, i.e. the nominal budget deficit shall not exceed 3% of GDP. From 2023, Estonian State can apply again the requirement of the State Budget Act to improve the structural budgetary position at least by 0.5% of GDP if in the previous year the general government structural position was in cumulative deficit and the general government structural position was in deficit. In 2020 to 2023, the requirement is exempted according to the general escape clause in the budgetary rules of the State Budget Act.

The government has set the target not to reduce the structural deficit over 2.6% of GDP by 2026. During 2023-2026, reducing the structural budget deficit is also not planned due to challenges related to energy price volatility and the need for defence investments. General goal of the fiscal policy is to preserve neutral or countercyclical budgetary policy. **In 2023, the government targets a structural budget deficit of 2.6% of GDP**, which is at the same level as this year. With this the government ensures that fiscal targets comply with the requirement of the State Budget Act at a time when the general escape clause is still in place.

According to Statistics Estonia the budgetary position of the general government was in a deficit of 2.4% of GDP, i.e EUR 756 million in 2021. Central government funds were in a deficit by 2.5 mainly due to the state budget, which was affected on the one hand by the decline in tax revenues and on the other hand by the increase in expenditures related to the crisis mitigation measures planned in the supplementary budget. At an aggregate level, the Estonian economy recovered from the crisis much faster than expected in the first place and the outcome was more positive. The financial situation of local governments also suffered due to the crisis through reduced income tax receipts and accelerated growth of expenses, the year ended with a budget deficit of 107 million euros. The budget surplus of social insurance funds resulted from the help of state support measures and more prudent spending, the year ended with a budget surplus of 136 million euros.

In 2022, the nominal budgetary position of general government, considering 2023 draft budget measures, reaches a nominal deficit of 2.7% of GDP, which exceeds with 0.5% the original state budget mainly due to the supplementary budget that was approved in the beginning of the summer 2022. The supplementary budget included measures to mitigate the costs of energy crises, the additional costs related to helping Ukraine and the refugees. **In 2023, according to the draft budget, nominal deficit will increase by about EUR 518 million and reach 3.9% of GDP.**

In 2021, the general government debt did decrease by 0,9 percentage points and reached 17.6% of GDP, amounting to EUR 5 034 million. Although, the debt increased nominally due to the increase in the debt level of Local governments and the State Treasury. This year, the debt burden of the general government can be expected to increase to 18.8% of GDP. This is due to a faster nominal rise in the debt level combined with slower nominal growth of GDP. **The general government debt rises to 19.8% of GDP by the end of 2023.**

The opinion of the Fiscal Council on the structural budget position objectives for 2023-2026

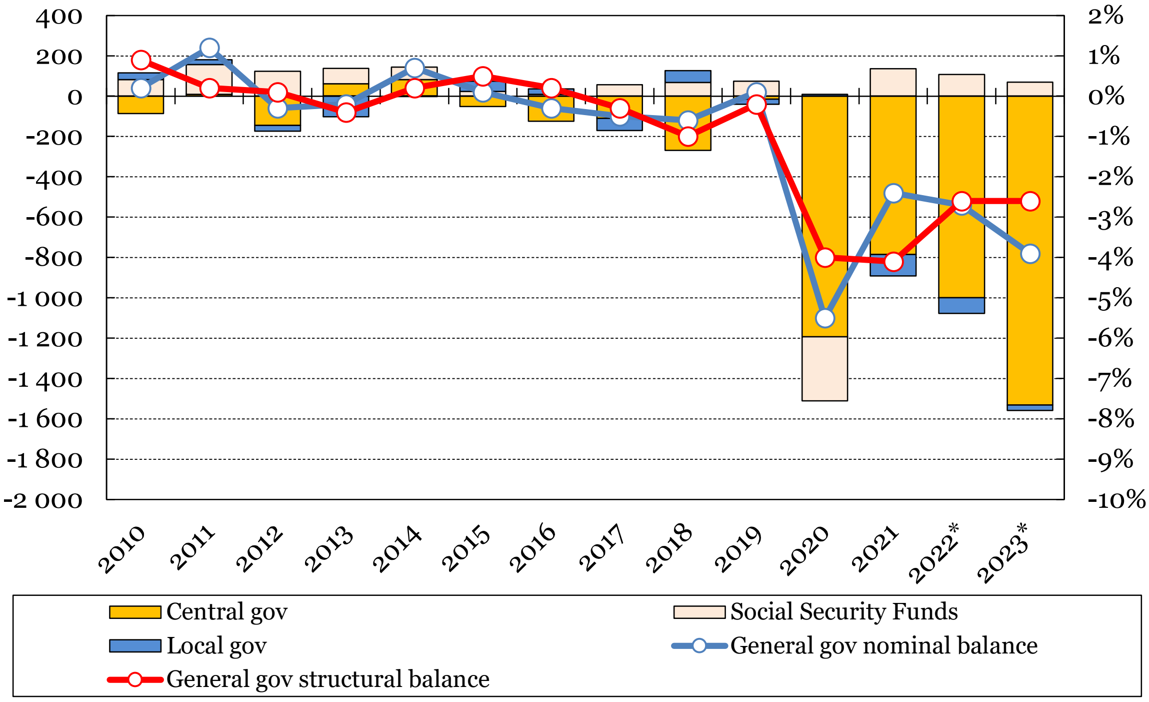
Pursuant to §14 of the State Budget Act, the Fiscal Council issued an opinion on the objectives of the structural budget position for 2023-2026 on 27 September.[3] Fiscal Council concluded that the government is aiming to keep running the structural budget deficit at the same level as in 2022, which the Ministry of Finance forecast at 2.6% of GDP. This means it has abandoned the target of reducing the structural deficit that was still considered a priority in the stability programme in spring. The deficit is being justified because of increased spending on defence and family support, and the need to compensate for the rise in electricity prices.

Fiscal Council points out that the budget strategy contains new spending that is permanent in nature, but no new permanent sources of revenue. The Fiscal Council understands that the additional extraordinary spending is necessary this year and next because of the war in Ukraine and high inflation. The fiscal rules have remained suspended across all of Europe for the same reasons. The Fiscal Council considers it important though that public finances be managed responsibly even when fiscal rules are temporarily suspended and there are severe cost pressures. This means that new revenue sources need to be found for the medium term that are not based only on borrowing.

Figure 3

General government budgetary position

(% of GDP)



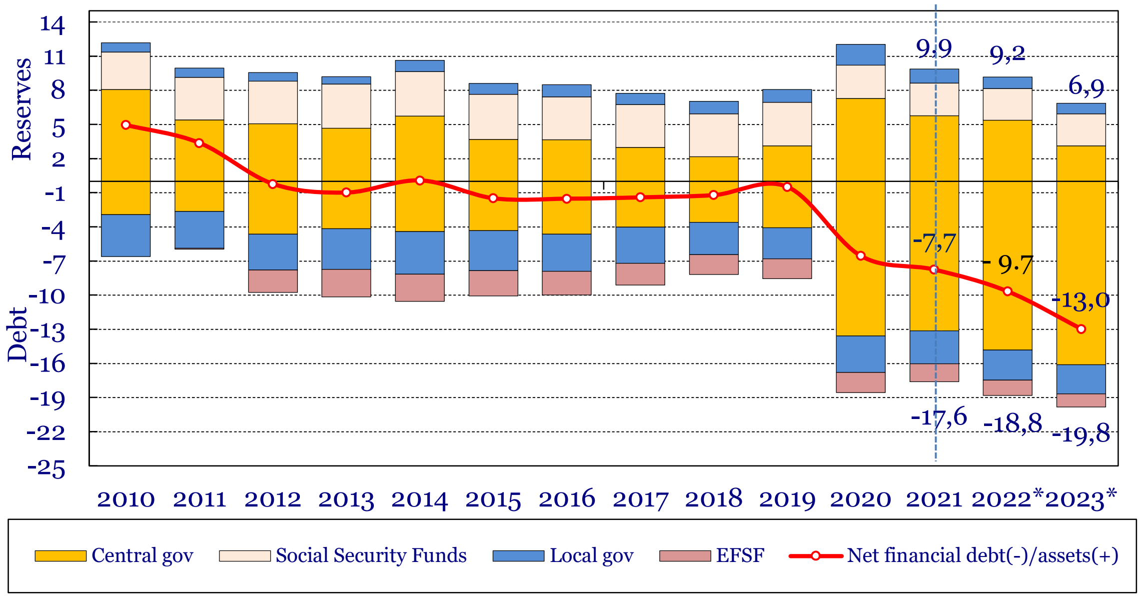
Source: Statistics Estonia, Ministry of Finance.

3 https://eelarvenoukogu.ee/news/the-fiscal-council-finds-the-government-should-start-to-reduce-the-budget-deficit-from-2024

Figure 4

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

(% of GDP)

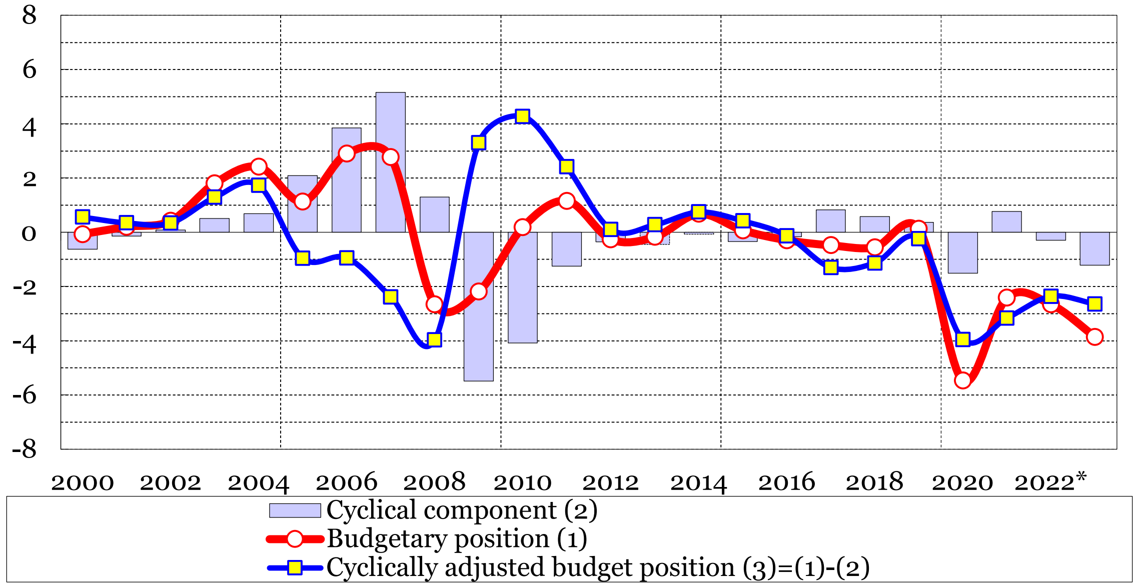


Source: Statistics Estonia, Ministry of Finance.

Figure 5

General government cyclically adjusted budgetary position

(% of GDP)

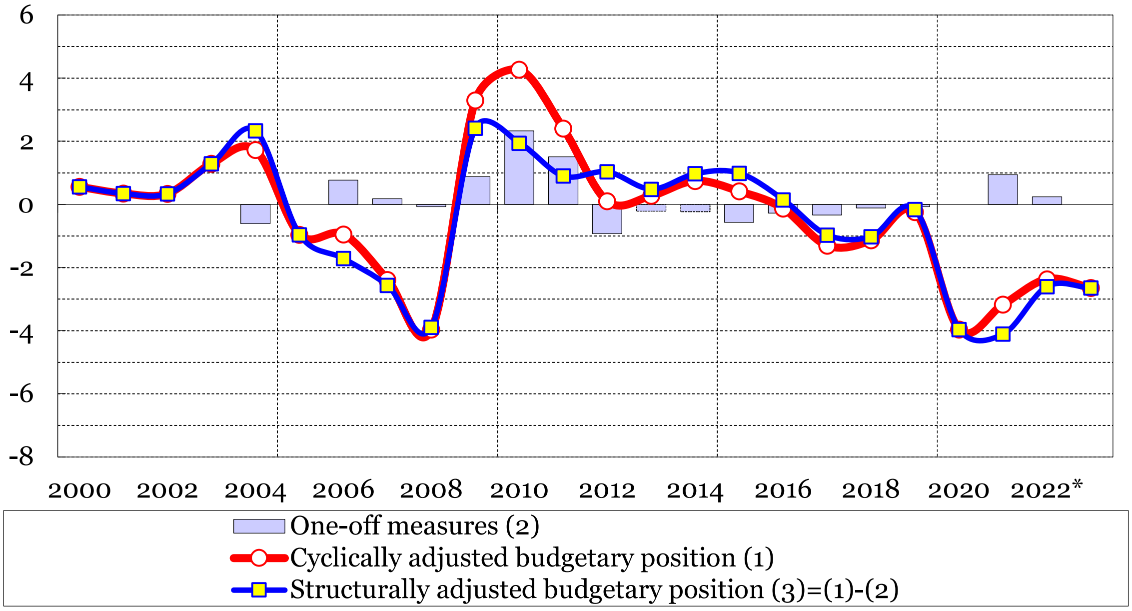


Source: Statistics Estonia, Ministry of Finance.

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	2022 (1/)	2023*
		% GDP	*% GDP*
Net lending (+) / net borrowing (-) (B.9) by sub-sector			
1. General government	S.13	-2.7	-3.9
2. Central government	S.1311	-2.7	-4.0
3. State government	S.1312	-	-
4. Local government	S.1313	-0.2	-0.1
5. Social security funds	S.1314	0.3	0.2
6. Interest expenditure	D.41	0.1	0.3
7. Primary balance (3/)		-2.6	-3.5
8. One-off and other temporary measures (4/)		0.2	0.0
9. Real GDP growth (%) (=1. in Table 1a)		0.5	3.0
10. Potential GDP growth (%) (=2 in Table 1.a)		3.2	2.5
contributions:			
- labour		1.4	0.8
- capital		1.2	1.2
- total factor productivity		0.6	0.5
11. Output gap (% of potential GDP)		-0.6	-2.5
12. Cyclical budgetary component (% of potential GDP)		-0.3	-1.2
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		-2.4	-2.6
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		-2.3	-2.3
15. Structural balance (13 - 8) (% of potential GDP)		-2.6	-2.6

1/ According to Draft 2023 State Budget.
2/ TR-TE= B.9.
3/ The primary balance is calculated as (B.9, item 1) plus (D.41, item 6).
4/ A plus sign means deficit-reducing one-off measures.

Source: Ministry of Finance.

Table 2.b. General government debt developments

	ESA code	**2022***	**2023***
		% of GDP	*% of GDP*
1. Gross debt		18.8	19.8
2. Change in gross debt ratio		1.2	1.0
Contributions to changes in gross debt			
3. Primary balance (=item 10 in table 2.a.i))		-2.6	-3.5
4. Interest expenditure	D.41	0.1	0.3
5. Stock-flow adjustment		1.0	-1.8
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/)		0.5	1.7
Other relevant variables			
6. Liquid financial assets (2/)		9.2	6.9
7. Net financial debt (7=1-6)		9.7	13.0
8. Debt amortization (existing bonds) since the end of the previous year [4]		1.3	1.1
9. Percentage of debt denominated in foreign currency		0.0	0.0
10. Average maturity [5]		7.2	7.5

1/ Proxied by interest expenditure divided by the debt level of the previous year.
2/ Liquid assets are here based on the accounting methodology which corresponds to the Consolidated Annual Report of the State. The definition of liquid financial assets covers the use of accounting standards, involving only those assets which are realizable in the short-term (including cash and deposits, debt securities, short-term trading quoted shares and investment fund shares)

Source: Ministry of Finance.

Table 2.c. Contingent liabilities

	2022*	**2023***
	% of GDP	*% of GDP*
Public guarantees	7.1	7.8
Of which: linked to the financial sector	7.0	7.7

Source: Ministry of Finance.

[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 a no-policy change scenario

Summer forecast (Table 3) differs from the Stability Programme forecast mainly because of an upward correction of revenue collection and downward correction of expenditures in 2022 and 2023. Revenue forecast was corrected upwards by 471.1 million euros in 2022 and by 842.1 million euros in 2023. Expenditure forecast was corrected downwards by 272.7 million euros in 2022 and by 30.4 million euros in 2023 mainly because the forecast for the use of external funds had decreased and several investment projects were postponed or cancelled.

Indicators as a percentage of GDP are not directly comparable - the summer forecast ratios are based on the revised GDP time series that were disclosed on 17.08.2022 whereas in the Stability Programme forecast ratios were based on earlier GDP data.

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

General Government (S.13)	ESA Code	2022*	2023*
		% of GDP	*% of GDP*
1. Total revenue at unchanged policies	TR	37.1	37.6
of which			
1.1. Taxes on production and imports	D.2	13.3	13.4
1.2. Current taxes on income, wealth, etc.	D.5	7.8	7.4
1.3. Capital taxes	D.91	0	0
1.4. Social contributions	D.61	11.6	11.8
1.5. Property income	D.4	0.35	0.32
1.6. Other		4.0	4.6
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		32.7	32.6
2. Total expenditure at unchanged policies	TE	39.8	39.6
of which			
2.1. Compensation of employees	D.1	10.2	9.9
2.2. Intermediate consumption	P.2	6.0	5.8
2.3. Social payments	D.62 D.632	14.0	14.2
of which Unemployment benefits		0.56	0.57
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0.07	0.25
2.5. Subsidies	D.3	0.8	0.5
2.6. Gross fixes capital formation	P.51	5.5	6.0
2.7. Capital transfers	D.9	1.2	1.1
2.8. Other		2.0	1.9

Source: Ministry of Finance.

4. Expenditure and Revenue targets. General government expenditure by function

The Draft Budgetary Plan (Table 4.a) differs from the summer forecast (Table 3) because of revenue and expenditure measures taken during the budget negotiation process and presented in Table 5.a. For calculating forecast ratios, the same forecast of GDP is used as in the summer.

For 2022, revenues increased more than expenditures thereby improving nominal position - revenues increased by 45.9 million euros and expenditures increased by 37.6 million euros. For 2023, revenue increased because of the government measures by 0.9% of GDP and expenditure increased by 2.7% of GDP, mainly due to compensation of employees, intermediate consumption and investments.

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

General Government (S.13)	ESA code	2022*	2023*
		% of GDP	*% of GDP*
1. Total revenue target	TR	37.2	38.5
of which			
1.1. Taxes on production and imports	D.2	13.3	13.9
1.2. Current taxes on income, wealth, etc	D.5	7.9	7.4
1.3. Capital taxes	D.91	0	0
1.4. Social contributions	D.61	11.6	12.2
1.5. Property income	D.4	0.35	0.32
1.6. Other		4.1	4.8
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		32.7	33.3
2. Total expenditure target	TE	39.9	42.3
of which			
2.1. Compensation of employees	D.1	10.2	11.2
2.2. Intermediate consumption	P.2	6.1	6.6
2.3. Social payments	D.62 D.632	14.0	14.6
of which Unemployment benefits		0.56	0.57
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0.07	0.31
2.5. Subsidies	D.3	1.1	0.7
2.6. Gross fixes capital formation	P.51	5.4	6.5
2.7. Capital transfers	D.9	1.1	0.5
2.8. Other		2.0	1.9

Source: Ministry of Finance.

In accordance with the SGP, the general government expenditure growth of a member state should be in line with its GDP growth. This expenditure benchmark is usually the 10-year average potential GDP growth (in a period from t-5 to t+4) of the member state, if the member state is at MTO. If the member state does not fulfil its MTO (general government structural deficit of up to 0.5% of GDP for Estonia) for the current year, the benchmark for the next will be set at an agreed upon lower level, which will help the member state adjust its position by at least 0.5% of GDP and fulfil its MTO. Due to the activation of the general escape clause of the SGP, no benchmark has been set for 2020-2023. The Commissions recommends that Estonia keep its expenditure in line with the potential growth of GDP. Therefore, we will set our benchmark using the 10-year (t-5 to t+4) average potential GDP growth estimate, which is 3.0% in 2021.

Adjusted expenditure growth[6] in 2021 was -1.1% and will be -5.0% in 2022, which is well below the benchmark. Estonia will breach the benchmark in 2023 when real expenditure growth will be 12.5%. However, it should be noted that this expenditure benchmark calculation does not consider the fact that there is a lag between the high GDP deflator and the overall expenditure adjustment by the government. When looking at a longer timeframe, for instance 2020-2024, the cumulative growth of expenditure (6.0%) is in line with potential growth of the economy (12.5%).

Table 4.b. Expenditure benchmark

	2021	**2021**	**2022***	**2023***
	level (m EUR)	*% GDP*	*% GDP*	*% GDP*
1. Expenditure on EU programmes fully matched by EU funds revenue	615.6	1.96	2.41	2.42
1a. of which investment fully matched by EU funds revenue	295	0.94	0.84	1.24
2. Cyclical unemployment benefit expenditure	92.4	0.29	0	0
3. Effect of discretionary revenue measures	308.1	0.98	0.46	-0.08
4. General government revenue increases mandated by law	0	0	0	0

Source: Ministry of Finance.

[6] In accordance with the European Commission's methodology, real expenditure growth is calculated using the GDP deflator. Excluded are interest expenditure and expenditure from table 4.b, also gross fixed capital formation is smoothed over time.

Table 4.c. General government expenditures by function

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

	2022*		**2023***	
	% of GDP	*% of general government expenditure*	*% of GDP*	*% of general government expenditure*
Education	5.5	13.8	5.7	13.6
Healthcare	5.9	14.8	6.1	14.4
Employment	0.6	1.4	0.6	1.3

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

Functions of the Government	**COFOG code**	**2022***	**2023***
		% of GDP	*% of GDP*
1. General public services	1	3.8	4.1
2. Defence	2	2.3	2.9
3. Public order and safety	3	1.9	2.2
4. Economic affairs	4	4.9	4.8
5. Environmental protection	5	0.7	0.7
6. Housing and community amenities	6	0.4	0.4
7. Health	7	5.9	6.1
8. Recreation, culture and religion	8	2.0	2.2
9. Education	9	5.5	5.7
10. Social protection	10	12.5	13.3
11. Total expenditure (=2. in Table 4.a)	**TE**	**39.9**	**42.3**

Source: Ministry of Finance.

5. Description of discretionary measures included in the draft budget

The discretionary measures that have an impact on state budget revenue and expenditure in 2023, have been compressed to 28 groups, that correspond to similar principles and objectives. Three of them have an impact on state budget revenue, seventeen of them affect state budget expenditure. All expenditure measures (total of EUR -1,4 billion) are temporary in nature, and they are used to cover the priority needs of the ministries. The Government has decided to increase the defence expenditure on the level of 2.9% of GDP and public R&D expenditure on the level of 1% of GDP. Wages also have a significant impact on the budget. The impact of the growth of salary fund for all employees in state budgetary institutions and an additional compensation of employees in priority areas is 231,2 million euros in 2023.

Energy measures for 2022-23 heating season differ significantly from the previous measures. The energy subsidies starting from the October of 2022 are automatic, i.e., the seller reduces the unit price of electricity, gas or district heating on the energy bills. Estimated foreseen effect for 2022-23 season is 217,88 million euros if one-time support for the transport sector to alleviate rise in fuel prices and energy measures for general and special care institutions are also considered. The effect is also reflected in 2023 budget. The actual cost depends on the level of energy prices, the change in the shares of electricity and gas contracts with fixed prices and those depending on the stock exchange price, and the price level of fixed contracts. The cost will also depend on electricity and gas consumption volumes in the coming months – these figures may change significantly compared to the forecast. As a financial instrument a liquidity measure has been foreseen for larger enterprises for next year in total amount of 100 million euros, but this has no effect on budget balance. The Government has also decided to extend once again the temporary lower excise duties on fuels and electricity for a year.

As of the end of September the number of Ukrainian refugees who have stayed in Estonia reaches about 60 thousand. The support to Ukrainian refugees will also increase social spending costs. To cope with the additional costs Estonia approved supplementary budget in 2022, which included support in connection with war refugees in total amount of 242 million euros. In 2023 state budget the reserve of 148 million euros has been created to cover necessary additional crises costs, including costs of refugees. There are no fixed measures decided to support war refugees in 2023 as the situation is unstable and the need for support in 2022 has been much smaller than expected.

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	
					2022 *	2023 *
					% of GDP	% of GDP
1) Raising the income tax-free minimum to 654 euros	Income tax-free threshold increase to €654 per month from January 2023	Revenue, D2, D5	Accrual method	Submitted with budget	0.00	-0.21
2) Extension of the current excise duty rates on fuel and electricity	Extension of the current excise duty rates on fuel and electricity until 1st April 2024, shifting of gradual increase	Revenue, D2	Accrual method	Submitted with budget	0.00	-0.04
3) Dividends with income tax	Additional dividends of state-owned enterprises (Tallinn Airport AS, Estonian Energy AS, Omniva, State Forest Management Centre)	Revenue, D4, D5	Accrual method	Draft is not required	0.14	0.23
4) Additional planning of the Recovery and Resilience Facility (RRF)	Additional investments from the Recovery and Resilience Facility (RRF): the construction of the Viljandi hospital, Western Estonia radar, energy efficiency of small houses, power grid strengthening program, multifunctional working boat.	Revenue, D7	Accrual method	Draft is not required	0.00	0.08
5) Supporting Ukraine	Acquisition of a field hospital for the Ukrainians from external funds	Revenue, D7	Accrual method	Draft is not required	0.00	0.02
6) Other revenues	Lowering waterway fees, proceeds from the sale of	Revenue, D2, D5, D6, P.11+P.12+P.131	Accrual method	Draft is not required	0.00	0.00

	immovable property, self-supporting measures					
7) Tax revenues from cost measures	Tax revenues from cost measures and non-taxable income of all measures	Revenue, D2, D5, D6, P.11+P.12+P.131	Accrual method	Draft is not required	-0.01	0.83
8) Additional planning of the Recovery and Resilience Facility (RRF)	Additional investments from the Recovery and Resilience Facility (RRF): the construction of the Viljandi hospital, Western Estonia radar, energy efficiency of small houses, power grid strengthening program, multifunctional working boat.	Expenditure, P51	Accrual method	Draft is not required	0.00	-0.08
9) Education in Estonian	Additional funding for transition to education in Estonian	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.11
10) Energy measures	Support measures for household consumers of electricity, gas and district heating, one-time support for the transport sector to alleviate rise in fuel prices, energy measures for general and special care institutions	Expenditure, D3	Accrual method	Draft is not required	0.00	-0.04
11) Ensuring high performance of public services	Increasing the capacity of organizations and the quality of public services.	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.03
12) General care service of pensioners	Reform of the financing of general care of pensioners	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.11

13) Health services	Funding mental health services and rehabilitation services. Maintaining genetic tests. Increasing the quality of replacement care service.	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.03
14) Higher education	Increased funding for higher education	Expenditure, D1, P2	Accrual method	Draft is not required	-0.03	-0.11
15) ICT and IT solutions	Increased cybersecurity, information security, launching of Republic of Estonia Information and Communiaction Technology Centre	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.15
16) Increase in operating expenses	Compensating increases in administrative expenses and operating expenses due to inflation. Strengthening the capacity of the Health Board to cope with crises.	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.10
17) Increase in wage costs	Growth of salary fund for all employees in state budgetary institutions. Additional compensation of employees in priority areas: teachers, cultural workers employees responsible for internal security, IT specialists.	Expenditure, D1	Accrual method	Draft is not required	0.00	-0.60
18) Increased interest expenses	Increased interest expenses	Expenditure, D41	Accrual method	Draft is not required	0.00	-0.07

19) Increases in child and family allowances and indexation	Increase in support for the first and second child, increasing support for families rich with children. Increased support for single parent children.	Expenditure, D62	Accrual method	Draft is not required	0.00	-0.42
20) Internal Security	Construction of the Eastern Border, improving crisis preparedness and migration procedures, development of civil society, building capacity to detect and combat money laundering and terrorism	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.07
21) Investment	Investments in the field of internal security, real estate and road maintenance. Compensating higher construction costs and property maintenance costs. Support for securing road connections. Regional planning. Establishment of the State Navy and waterway maintenance.	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.03	-0.06
22) Research and development activities	Maintain R&D costs as 1% of GDP to ensure sustainability of science and higer education	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.11
23) Reserve funds and other costs	Coverage of Estonian Railway losses, obligations	Expenditure, D1, D62, D7, P2, P51	Accrual method	Draft is not required	-0.14	-0.30

	arising from legislation, membership fees, entrepreneurship subsidies, environment, real estate optimization fund, international recognition of accreditations issued by Estonian Accreditation Centre. Establishment of the State Navy, waterway maintenance, support measure for passenger shipping. Social assistance for repressed.					
24) Security	Creation of middle-earth air defense capabilities, extensive national defence. Funding additional allied infrastructure and national crisis management training. Changes between years in security packages.	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.18
25) Shifting costs between years	Shifting costs between years as several investment projects and construction procurements are postponed	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.04	-0.05
26) Sports, entertainment and recreation	Cultural programs, promoting physical movement, developing sports ground and indoor sports facilities.	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.03

27) Supporting Ukraine	Acquisition of a field hospital from external funds	Expenditure, P51	Accrual method	Draft is not required	0.00	-0.02
28) Ukraine war refugees and supporting Ukraine	Promotion of sanctions and prevention of impunity in connection with the war in Ukraine, costs related to Ukrainian war refugees. The support fund for local governments.	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.11
Total revenue measures					**0.13**	**0.90**
Total expenditure measures					**-0.10**	**-2.78**
TOTAL					**0.02**	**-1.88**

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	
					2022 *	2023 *
					% of GDP	*% of GDP*
1) Raising the income tax-free minimum to 654 euros	Income tax-free threshold increase to €654 per month from January 2023	Revenue, D2, D5	Accrual method	Submitted with budget	0.00	-0.21
2) Extension of the current excise duty rates on fuel and electricity	Extension of the current excise duty rates on fuel and electricity until 1st April 2024, shifting of gradual increase	Revenue, D2	Accrual method	Submitted with budget	0.00	-0.04
3) Dividends with income tax	Additional dividends of state-owned enterprises (Tallinn Airport AS, Estonian Energy AS, Omniva, State Forest Management Centre)	Revenue, D4, D5	Accrual method	Draft is not required	0.14	0.23
4) Additional planning of the Recovery and Resilience Facility (RRF)	Additional investments from the Recovery and Resilience Facility (RRF): the construction of the Viljandi hospital, Western Estonia radar, energy efficiency of small houses, power grid strengthening program, multifunctional working boat.	Revenue, D7	Accrual method	Draft is not required	0.00	0.08
5) Supporting Ukraine	Acquisition of a field hospital for the Ukrainians from external funds	Revenue, D7	Accrual method	Draft is not required	0.00	0.02

6) Other revenues	Lowering waterway fees, proceeds from the sale of immovable property, self-supporting measures	Revenue, D2, D5, D6, P.11+P.12+P.131	Accrual method	Draft is not required	0.00	0.00
7) Tax revenues from cost measures	Tax revenues from cost measures and non-taxable income of all measures	Revenue, D2, D5, D6, P.11+P.12+P.131	Accrual method	Draft is not required	-0.01	0.83
8) Additional planning of the Recovery and Resilience Facility (RRF)	Additional investments from the Recovery and Resilience Facility (RRF): the construction of the Viljandi hospital, Western Estonia radar, energy efficiency of small houses, power grid strengthening program, multifunctional working boat.	Expenditure, P51	Accrual method	Draft is not required	0.00	-0.08
9) Education in Estonian	Additional funding for transition to education in Estonian	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.11
10) Energy measures	Support measures for household consumers of electricity, gas and district heating, one-time support for the transport sector to alleviate rise in fuel prices, energy measures for general and special care institutions	Expenditure, D3	Accrual method	Draft is not required	0.00	-0.04
11) Ensuring high performance of public services	Increasing the capacity of organizations and the quality of public services.	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.03

12) General care service of pensioners	Reform of the financing of general care of pensioners	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.11
13) Health services	Funding mental health services and rehabilitation services. Maintaining genetic tests. Increasing the quality of replacement care service.	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.03
14) Higher education	Increased funding for higher education	Expenditure, D1, P2	Accrual method	Draft is not required	-0.03	-0.11
15) ICT and IT solutions	Increased cybersecurity, information security, launching of Republic of Estonia Information and Communiaction Technology Centre	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.15
16) Increase in operating expenses	Compensating increases in administrative expenses and operating expenses due to inflation. Strengthening the capacity of the Health Board to cope with crises.	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.10
17) Increase in wage costs	Growth of salary fund for all employees in state budgetary institutions. Additional compensation of employees in priority areas: teachers, cultural workers employees responsible for internal security, IT specialists.	Expenditure, D1	Accrual method	Draft is not required	0.00	-0.60

18) Increased interest expenses	Increased interest expenses	Expenditure, D41	Accrual method	Draft is not required	0.00	-0.07
19) Increases in child and family allowances and indexation	Increase in support for the first and second child, increasing support for families rich with children. Increased support for single parent children.	Expenditure, D62	Accrual method	Draft is not required	0.00	-0.42
20) Internal Security	Construction of the Eastern Border, improving crisis preparedness and migration procedures, development of civil society, building capacity to detect and combat money laundering and terrorism	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.07
21) Investment	Investments in the field of internal security, real estate and road maintenance. Compensating higher construction costs and property maintenance costs. Support for securing road connections. Regional planning. Establishment of the State Navy and waterway maintenance.	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.03	-0.05
22) Research and development activities	Maintain R&D costs as 1% of GDP to ensure sustainability of	Expenditure, D1, P2	Accrual method	Draft is not required	0.00	-0.11

	science and higer education					
23) Reserve funds and other costs	Coverage of Estonian Railway losses, obligations arising from legislation, membership fees, entrepreneurship subsidies, environment, real estate optimization fund, international recognition of accreditations issued by Estonian Accreditation Centre. Establishment of the State Navy, waterway maintenance, support measure for passenger shipping. Social assistance for repressed.	Expenditure, D1, D62, D7, P2, P51	Accrual method	Draft is not required	-0.14	-0.30
24) Security	Creation of middle-earth air defense capabilities, extensive national defence. Funding additional allied infrastructure and national crisis management training. Changes between years in security packages.	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.18
25) Shifting costs between years	Shifting costs between years as several investment projects and construction procurements are postponed	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.04	-0.05

26) Sports, entertainment and recreation	Cultural programs, promoting physical movement, developing sports ground and indoor sports facilities.	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.03
27) Supporting Ukraine	Acquisition of a field hospital from external funds	Expenditure, P51	Accrual method	Draft is not required	0.00	-0.02
28) Ukraine war refugees and supporting Ukraine	Promotion of sanctions and prevention of impunity in connection with the war in Ukraine, costs related to Ukrainian war refugees	Expenditure, D1, P2, P51	Accrual method	Draft is not required	0.00	-0.08
Total revenue measures					**0.13**	**0.90**
Total expenditure measures					**-0.10**	**-2.73**
TOTAL					**0.02**	**-1.83**

Source: Ministry of Finance.

6. Links between the draft budgetary plan and country specific recommendations

In this chapter information is presented on how the measures in the draft budget plan take into account the country-specific recommendations (CSRs).[7]

Table 6.a. Country-specific recommendations

CSR no	List of measures	Description of direct relevance
1.	In 2023, ensure that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance, taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Stand ready to adjust current spending to the evolving situation. 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. For the period beyond 2023, pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions.	Overall, the economy has a strong effect of high energy prices and inflation, which has caused significant decrease of purchasing power of households. Considering the need for additional defence costs due to the war in Ukraine, the Government has approved remarkable fiscal stimulus for 2023 and onwards. General Government structural budget deficit of 2.6% of GDP is targeted for 2022. In the following years the deficit is set to stay on the same level. The direct fiscal impulse to the economy in 2023 is expected to be negative. The measures and activities that help maintain the overall neutral fiscal stance: - Creating Government reserves to cover additional potential costs of different crises, including costs of COVID and war refugees. - Energy support to households and liquidity measure for large companies. The fuel and electricity excise duties will be kept on lower rate for year longer. - Implementation of RRF and REPowerEU and other Union funds Public investments for the green and digital transitions, and for energy security: Green Transition policy coordination is led by the Committee of Green Transition, which is chaired by the Prime Minister and includes 8 other Ministers. The committee is in charge of a coherent green policy development, in order to ensure consistence of different sectoral policies and their respective goals. The Committee also discussed Estonia's positions in relation to the Fit for 55 package of legal acts and amendments to those, and will maintains an overview of progress towards Estonia's own objectives for 2030 and 2050. In addition, starting from January 2022, a specific team for green policy coordination was created in the Government Office to facilitate cooperation across sectors and to make proposals for a coherent policy implementation. With the objective of contributing to energy security, diversification of energy sources, and green objectives at large, Estonia has planned state budget support investments into energy efficiency of buildings (both dwellings and public sector buildings) with nearly EUR 1000 million within the 2021-2027 period, and the planned public sector support to improvement of renewable energy (production and consumption) in this

[7] https://data.consilium.europa.eu/doc/document/ST-9747-2022-INIT/en/pdf

		period is approximately EUR 300 million, triggering considerable investments. The overall contribution to green policy objectives is considerably larger, covering measures in different emission reduction and biodiversity related areas ranging from greener transport to promotion of skills relevant to the challenges. The dynamics of implementation of these measures over the years will differ, however, related investments in 2023 will amount to some 1/7 of these overall amounts. In the area of digital transition we invest EUR 439 million during next five years from EU funds focusing on both public and private sector. The leap areas that we are concentrating on cover proactive and event-based services, AI-powered government, human-centric data governance and next generation digital government. With EU funds contribution we´ll focus on proactive and seamless digital service delivery and rebirth of core government IT services and infrastructure to take digigov to cloud, which will guarantee better service experience, lower the administrative burden and cost, rise the data quality and create higher resilience against cyber risks. We are investing into data based leadership, data-driven governance and reuse of data, as well as in futureproof digital government platform for empowering digital change in public sector. In private sector, we plan to support enterprises with EUR 80 million for rolling-out digital technologies and introduce digital solutions to boost productivity and sustainability. Our priority is also to improve connectivity by investments (EUR 64 million) in deployment of very high capacity network in rural areas.
2.	Proceed with the implementation of its recovery and resilience plan, in line with the milestones and targets included in the Council Implementing Decision of 29 October 2021. Submit the 2021–2027 cohesion policy programming documents with a view to finalising the negotiations with the Commission and subsequently starting their implementation.	*Recurring country-specific recommendation*
3.	Strengthen social protection, including by extending the coverage of unemployment benefits, in particular to those with short work spells and in non-standard forms of work.	The bill for flexible unemployment insurance benefits, that links the duration of the benefit payment to the state of the labour market is being read in the Riigikogu. The unemployment insurance benefit shall be paid for longer if the situation on the labour market is bad and the number of unemployed is increasing. If it is easier to find a job and the number of unemployed is low, the benefit is paid as long as the so-called base period is set at the time of application. The aim is to give people confidence in difficult situations and to motivate them to return to work quickly in better times. The amendment is expected to enter into force on 30 June 2023. Since 1 June 2022 the subsistence level is 200 euros per month for a person living alone or for the first family member of the family; 240 euros (120% of single rate) per month for each child under 18 years of age and 160 euros (80% of single rate) per month for the second and each following adult family member.

	Improve the affordability and quality of long-term care, in particular by ensuring its sustainable funding and integrating health and social services.	On 13 April 2022, the Parliament adopted amendments to the Social Welfare Act and Family Law Act, that stipulate the long-term care definition, task local governments with an obligation to identify/asses the need for support for a person with a care burden and while providing assistance, prefer home services to institutional ones. The amendments enter into force on 08 of May in 2022 On 29 September 2022 the Government adopted amendments to the Social Welfare Act that reduce a person's co-payment for general care services. The local government shall finance the work of a qualified care worker costs. Costs related to accommodation, meals and additional personal needs, will be covered by the service users. It is expected that the general care home service will become available for an average pension. The amendments have been submitted to the Parliamentary procedure and are expected to enter into force on 1 July 2023. The Government has decided to allocate additional 40 million euros from the state budget in 2023 to improve the availability and quality of general care services both in care homes and as services that support living at home. In 2024, nearly 57 million euros will be provided to the local government's revenue base from the state budget. The funding will increase yearly in accordance with the income tax revenues and is expected to reach 62 million euros by 2026. In 2018, with the support from the European Commission's DG REFORM (formerly the Structural Reform Support Service), an integrated care reform initiative was launched, aiming to contribute to the development of a more integrated and person-centred provision of social, medical, and vocational support services to people with disabilities and olde people with high support needs in Estonia. The recommendations made have been integrated mostly into the development of the person-centred social welfare and health system coordination model. The current implementation phase of regionally flexible coordination model started in September 2020 in eight partnership regions involving 16 local governments. The next implementation phase is planned to start in 2023. The aim is to achieve country-wide implementation, together with needed ICT developments (including use of integrated data for policymaking), in-service training for social and health care specialists and a new integrated funded model for the coordination system in 2025.
4.	Reduce overall reliance on fossil fuels and diversify imports of fossil fuels by accelerating the deployment of renewables, including through further streamlining of permitting procedures, ensuring sufficient capacity of interconnections and strengthening the domestic electricity grid.	The Government has set a goal to reach 100% renewables in the share of gross final energy consumption of electricity by 2030. It is planned to set this goal in the relevant legislation, which is currently in the final stages in the Parliament. To achieve this goal, additional renewable electricity reverse auctions will be conducted (in addition to the 450 GWh one completed in 2022 and 650 GWh one in the beginning of 2023 in total of 1 TWh of auctions are planned for 2024 and 2025). In addition, a thorough audit on the permitting process has been conducted and relevant needed legislative changes have been identified. Regarding the strengthening of the electricity grid, the ongoing investments done under RRF and CEF Energy projects (synchronisation) are continuing. Additional EUR 8 million has been allocated for boosting available capacities for renewable generators' connections in the electricity distribution grid in 2022 and the Government plans to propose to allocate

	Increase energy efficiency, in particular the energy efficiency of buildings, to reduce energy consumption.	additional EUR 49 million while changing the recovery and resilience plan of Estonia. Estonia is set to use a significant amount (hundreds of millions of euros) from the structural funds to co-finance investments into energy efficiency in housing. Additional funds were allocated from the 2022 budget as well and are being planned for the 2023 budget (incl. for industries). To boost the effect of high prices in reducing the energy consumption, the Government is giving out constant messages and tips to reduce consumption.
	Intensify efforts to improve the sustainability of the transport system, including through electrification of the rail network and by increasing incentives to encourage sustainable and less polluting transport, including the renewal of the road vehicle stock.	Estonia is extending the electrified sections of the railway to Narva and Tartu. Has signed contracts for the purchase of trains for 150 million euros to service the new electrified railway lines. About 290 million euros will be spent on railway electrification. The construction period of the project is 2023-2026. The construction of the Rail Baltica railway has also entered the intensive construction stage. The state supports Tallinn with 76.5 million euros for the extension of tram lines. The state supports three major cities with 40 million euros for the construction of bicycle paths in the city centres in a total amount of 40 million euros. The contribution of the local government is added to the projects by approx. 30%.

7. Divergence from the latest Stability Programme

Estonia's Stability Programme 2022 was based on the spring forecast of the Ministry of Finance. The forecast originates from the estimate of economic situation as of 7. April 2022. The 2023 State Budget and the State Budget Strategy for 2023-2026 are based on the summer economic forecast, published on 23. August 2022.

The summer forecast of the Ministry of Finance expects GDP to grow by 1 per cent in 2022 and by 0.5 per cent in 2023. The growth is faster in 2022 and slower in 2023 compared to the spring forecast on which the Stability Programme was based. Several economic activity indicators turned out to be quite strong until the summer, but some slowdown in economic activity has been visible since then. Economic sentiment has been deteriorating for almost a year now and a moderate decline in GDP in the end of 2022 and the first quarters of 2023 is very probable. The growth in nominal GDP in 2022 and 2023 is forecast to be faster in the summer forecast compared to the spring forecast since inflation has turned out to be faster and inflation forecast has been raised.

The revision of the forecast is caused by better performance of the Estonian economy in the first half of 2022 despite trade restrictions and price increases. At the same time, confidence in all areas of activity has continued to deteriorate fast, which inevitably means weaker performance during the following quarters than previously expected. This results in better than previously expected performance of real GDP in 2022 (+2pp) and slightly lower growth in 2023 (-0,7pp) and 2024 (-0,2pp).

As we expected external trade flows to Russia to come to an end, which will have a negative impact on our trading partners as well, quite pessimistic forecast was made in the Stability Programme. However, exports in the first half of 2022 showed good performance. Therefore, exports growth for 2022 has been revised up by 5%. However, foreign environment is getting weaker and price pressures keep increasing, cutting the outlook for our trading partners. Therefore 1,6% growth of exports is forecast for 2023, which is 0,7% lower compared to spring forecast.

HICP inflation forecast for 2022-2023 is 6.8 and 4.6 percentage points higher respectively compared to the Stability Programme. This is mostly the aftermath of the war in Ukraine, pushing the energy and other commodity prices higher. Core inflation has been revised upside as well due to the pass through of higher energy costs on other goods and services prices. The recovery of tourism sector and the reduction of COVID-19 restrictions has driven services inflation as well.

Labour market situation remains strong and reaction to worsening sentiment has been moderate. Firstly, this reflects the general economic situation, which was surprisingly good until the summer. Secondly, the impact from Ukrainian war refugees entering Estonian labour market was added to the summer forecast; this was not included in spring forecast. Refugees have been surprisingly active, which gives also some positive effect and ease labour shortages in some sectors. As a result of these factors, unemployment is forecast to increase by around one percentage point only by the beginning of 2023, which is about 1/3 of the negative impact assumed in spring this year.

Wage growth has performed better than forecast in spring. This is due to rapid inflation and recovery from the COVID-19 crisis. Companies have been able to pass commodity price hikes on to their sales prices surprisingly successfully, which means that they have finances to increase wage bill as well. However, the loss of purchasing power is expected to be more negative and for a longer period of time.

The strength of **private consumption** has surprised positively in the first half of 2022 in real and especially in nominal terms. This is partly because of high inflation of compulsory energy related goods and services (housing, transportation, food). Another reason is that sharply deteriorating consumer confidence has not shown up in higher saving rates. In addition to that, consumption has been supported by the large amount of war refugees (4,5% of population). Higher inflation has also pushed up nominal wage growth, which has been possible due to higher revenues of companies. Upgraded wage growth forecast shows up also in consumption.

The general government budgetary position in 2022 has improved by 2.6% of GDP compared with the Stability Programme and is now expected to be in a deficit of 2.7% of GDP. The improvement is mainly due to better tax revenue collection, which affect all levels of government. The general government nominal budget projection for 2023 has improved by about 1.0% of GDP compared to the Stability Programme.

In 2022, the **tax burden** forecast compared to the Stability Programme has been revised downwards by 1.5 pps to 32.7% of GDP. Tax revenues increased mainly because of VAT and social tax. High inflation has impact on both through prices and wages. Stronger than expected labour market performance also increased PIT. CIT revenues increase was significant in the first half of 2022 due to private sector profit distribution and state enterprises dividends were increased. In total GDP upward correction was higher than the tax revenues growth. In 2023, the tax burden has been revised downwards by 0.3 pps to 33,3% of GDP. As on 2022 tax revenues increased mainly because of VAT and social tax. Also sales revenues from CO2 emission quotas increased consumption taxes. PIT revenues were corrected upwards although basic allowance increased. And CIT revenues were also corrected upwards due to base effect of 2022 and state enterprises dividends were increased. In total GDP upward correction was little bit higher than the growth of tax revenues.

Forecast of general government debt has been decreased by 1.9% of GDP in 2022 and by 4.3% of GDP in 2023, compared to the forecast included in the Stability Programme due to higher projected tax receipts and improved budgetary position in this and next year.

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

	ESA code	**2021**	**2022***	**2023***
		% of GDP	*% of GDP*	*% of GDP*
General government structural balance (1/) target	B.9		B.9	
Stability Programme		-3.8	-4.5	-3.5
Draft Budgetary Plan		-4.1	-2.6	-2.6
Difference		-0.3	1.9	0.8
General government structural balance projection at unchanged policies	B.9		B.9	
Stability Programme		-3.8	-4.5	-3.5
Draft Budgetary Plan (2/)		-4.1	-2.6	-0.8
Difference		-0.3	1.9	2.7

1/ Budgetary position is targeted by structural balance.
2/ Actual (t-1) and summer forecast (t, t+1).
Source: Statistics Estonia, Ministry of Finance.

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

	ESA code	**2021**	**2022***	**2023***
		% of GDP	*% of GDP*	*% of GDP*
General government net lending/ net borrowing target	B.9		B.9	
Stability Programme		-2.4	-5.3	-4.8
Draft Budgetary Plan		-2.4	-2.7	-3.9
Difference		0.0	2.6	1.0
General government net lending/ net borrowing projection at unchanged policies	B.9		B.9	
Stability Programme		-2.4	-5.3	-4.8
Draft Budgetary Plan (1/)		-2.4	-2.7	-2.0
Difference		0.0	2.6	2.8

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

Annex

Table 8. Guarantees adopted/announced in response to COVID-19 outbreak

Description of measures	Adoption status	Maximum amount of contingent liability (% of GDP)	Current take-up (actual contingent liability, % of GDP)
Loan guarantees for bank loans already issued in order to allow for repayment schedule adjustments and other (Kredex)	Already adopted	1.3	0.4
Loan guarantees for bank loans already issued, increase of the guarantee reserve and reduction of guarantee fees (MES)	Already adopted	0.5	0.2
	Total	1.78	0.59

Source: Ministry of Finance.

Table 9. Table of the RRF impact on programme's projections

Revenue from RRF grants (% of GDP)	2020	2021	2022	2023	2024	2025	2026
RRF GRANTS as included in the revenue projections		0.006	0.525	0.307	0.387	0.529	0.387
Cash disbursements of RRF GRANTS from EU		0.401	0	0.974	0.485	0.163	0.221

Expenditure financed by RRF grants (% of GDP)	2020	2021	2022	2023	2024	2025	2026
TOTAL CURRENT EXPENDITURE		0.004	0.070	0.080	0.069	0.041	0.017
Gross fixed capital formation P.51g		0	0.074	0.086	0.076	0.020	0.007
Capital transfers D.9		0.002	0.108	0.141	0.241	0.468	0.362
TOTAL CAPITAL EXPENDITURE		0.002	0.181	0.227	0.318	0.489	0.369

Other costs financed by RRF grants (% of GDP)[1]	2020	2021	2022	2023	2024	2025	2026
Reduction in tax revenue		0	0	0	0	0	0
Other costs with impact on revenue		0	0	0	0	0	0
Financial transactions		0	0.274	0	0	0	0

[1] *This covers costs that are not recorded as expenditure in national accounts*