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MINISTEERIUM

MINISTRY of FINANCE of the REPUBLIC of ESTONIA

2019 Draft Budgetary Plan of Estonia

Tallinn, 15. October 2018

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Introduction

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

Preparation and assessment of budgetary plans in autumn is an additional step in a framework of coordinated surveillance, which already included presenting and assessing the Stability Programmes by the Council and the Commission in spring. This contributes to coordination of policies 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 State Budget Strategy for the next four years and the 2018 Stability Programme was approved by the Government on 26 April 2018. **The draft 2019 State Budget with explanatory memorandum was approved on 26 September in the meeting of the Government and at the same day it was given for proceeding to Parliament.**

The draft 2019 State Budget of the Republic of Estonia is based on State Budget Strategy 2019–2022, The Government's Action Programme and The European Commission and the Council recommendations¹ (given according to the Stability Programme and Estonia's 2020 Competitiveness plan) and designed activities according to these. In the formulation of the budgetary policy, the Stability and Growth Pact requirements on the budgetary policy of the EU Member States is being respected.

In 2019, Estonia's general government structurally adjusted budgetary position is planned in a balance of 0.0% of GDP, in line with the target set in the State Budget Strategy. Thus Estonia holds its medium-term objective, which is a structural deficit up to 0.5% of GDP.

¹ Estonia's country-specific recommendations shortly:

- (1) Ensure that the nominal growth rate of net primary government expenditure does not exceed 4.1% in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP. Improve the adequacy of the social safety net and take measures to reduce the gender pay gap.
- (2) Promote research and innovation, in particular by providing effective incentives for broadening the innovation base.

More detailed country-specific recommendations and accompanying analysis can be found from European Commission's website: https://ec.europa.eu/info/strategy/european-semester/european-semester-your-country/estonia/european-semester-documents-estonia_en

Activities to comply with the recommendations of European Commission are published annually: <https://riigikantselei.ee/en/supporting-government/national-reform-programme-estonia-2020>.

1. Macroeconomic forecast

The Draft 2019 State Budget of the Republic of Estonia is based on the summer forecast of the Ministry of Finance (MoF), published on 11 September 2018. External assumptions of the forecast were fixed in late August 2018. Economic forecasts of the Ministry of Finance are public and can be found from the web page of the ministry (<https://www.rahendusministeerium.ee/et/riigieelarve-ja-majandus/majandusprognoosid>).

In 2017, the external environment was the most favourable of recent years, with accelerating economic growth rates both in the euro area and the main trading partners, thus leading to stronger import demand. Economic sentiment indexes in Estonia and many neighbouring countries have already peaked and their downward trend is partly led by spreading trade restrictions, nevertheless, the economic state is still good.

The growth of Estonia's gross domestic product slowed in the first half of 2018 to more sustainable level (3.5%). Growth was mainly driven by domestic demand, but export growth continued. According to the forecast baseline scenario, Estonia's economy will grow 3.6% in 2018 and 3% in 2019. Domestic demand is the main driver for growth, which is based largely on private consumption growth this year, but will support the recovery of investment growth in coming years. Export growth will continue in line with external demand, and its contribution to growth should increase. In 2020-2022 the Estonia's economy is forecast to grow by an average of 2.8% per annum. Growth is supported by relatively rapid export growth, but the contribution of domestic demand remains stable due to private consumption and investment growth.

Investment supported **domestic demand** strongly during 2017, growing by 13%, while private consumption growth decelerated to 2.5% because of consumer price acceleration. Consumption growth has accelerated in 2018 due to stronger real wage growth and should stay around 4% during 2018-2019, decelerating after that as employment growth slows down and turns slightly negative from 2020 onwards. Household saving rate has been increasing slightly and is almost where it hiked in 2009. Investment growth may turn temporarily negative in 2018 because of the base effect which raised corporate investment level in some sectors a year before. The government and households' sectors should stay strong and growing steadily also in 2018 and thereafter.

Though economic growth peaked in 2017, developments in our export markets are still favourable. Considering the slowdown of foreign trade, trade barriers and related uncertainty, foreign demand will turn to be more modest compared to spring forecast, but remains vigorous in historical comparison. **Exports of goods and services** is expected to grow by 3.4% in 2018. Similarly to 2017, growth of exports is driven by broad based services exports. The success of services sector is primarily based on increasing exports of ICT and transport services. Growth of goods exports is dragging the shortage of export orders of communication equipment. Expecting stabilisation in the volumes of communication equipment, growth of exports is expected to pick up to 3.8% in 2019. This is similar with the dynamics of foreign demand growth. In line with foreign demand, growth of exports will stabilise at around 3.7% in the following years. Imports will increase by 4.9% in 2018, being supported by the increase in public sector investment activity and the upturn of private consumption followed by the income tax reform.

Current account surplus was at its historical high, reaching 3.2% of GDP in 2017. In 2018, the external balance is being affected by the strengthening of goods imports, causing the decline in current account surplus to 2.2% of GDP. Gradual increase in investment activity and the expected recovery of foreign companies' profitability will lower the current account surplus in coming years.

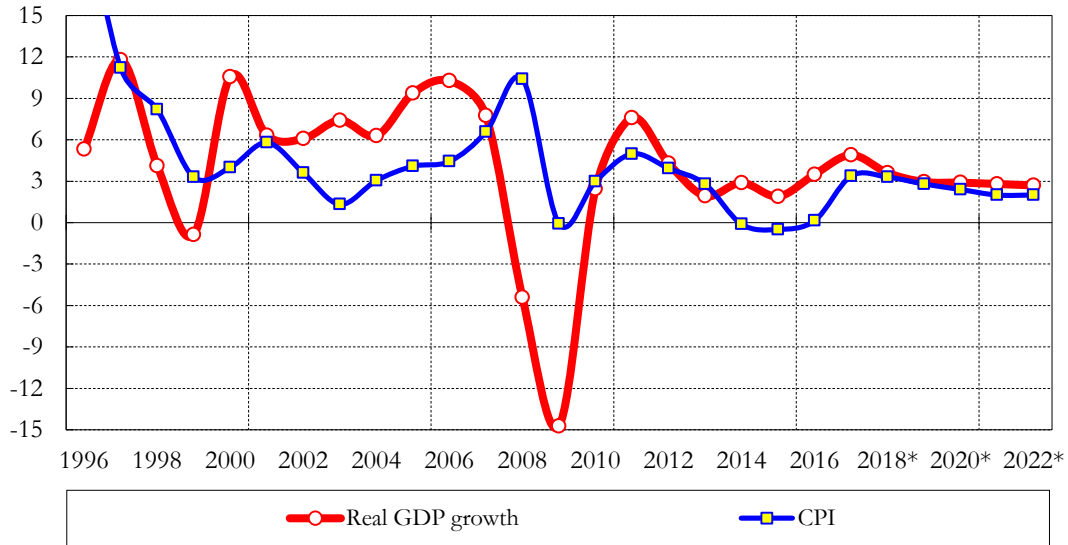
Taking into account that energy prices will continue to be at a high level, food prices will be increasing due to draught and services **inflation** is picking up, no slowdown of inflation can be expected in the second half of 2018. Consumer prices will grow by 3.3% in 2018. Food and services inflation will pick up slightly in 2019, but the stabilisation of energy prices and decreasing impact of tax measures will cause the slowdown of inflation to 2.8%. While growing food prices are related to the impact of draught, pick up in services inflation is related to fading temporary factors and high wage growth, stemming from above potential output growth and lack of labour force. Energy prices will be affected by the expected stabilisation of crude oil prices and falling electricity exchange prices. Indirect taxes, including excise duty increases for alcohol add 0.5% to CPI. In the end of the forecast period inflation will slow down to 2% as a result of fading tax measures and small impact of foreign factors.

In the first half of 2018, positive **labour market** developments continued - **employment** increased by 1.3% and **unemployment** remained close to 6%. Employment growth was relatively widespread and the number of employees increased in most of the sectors. Shrinking working age population and relatively low unemployment have led to a situation, where for companies finding new workers is more and more complicated. Favourable sentiment and expected increase in order books for coming months both in manufacturing and construction increase demand for labour. Labour constraints are eased by changes in Aliens Law, enforced from July this year. In 2019, employment growth is forecast to decelerate to 0.8% due to moderating economic growth and labour supply constraints. Employment level is expected to decline due to shrinking working age population at the end of the forecast horizon. Labour market participation is also affected by Work Ability Reform. The unemployment rate is expected to increase to 6.6% by 2022, mostly due to increasing activity among disabled persons.

Average wage growth is in line with GDP developments and reached 7% in the first half of 2018. Wage growth is broad-based. From largest sectors, construction, wholesale and retail activities experienced above average wage growth rates. In some sectors with below average wage levels the wage growth has decelerated despite labour constraints. The 2018 changes in basic income tax allowance have reduced tax burden on low incomes significantly. As a result of increased basic allowance, net wage income increased by 9% during first half of 2018. According to the forecast, a 7% gross wage growth is expected in 2018, which is forecast to decelerate to 6% in 2019 due to moderating economic growth. Due to labour constraints wage bill to GDP ratio is not expected to improve in coming years.

Figure 1

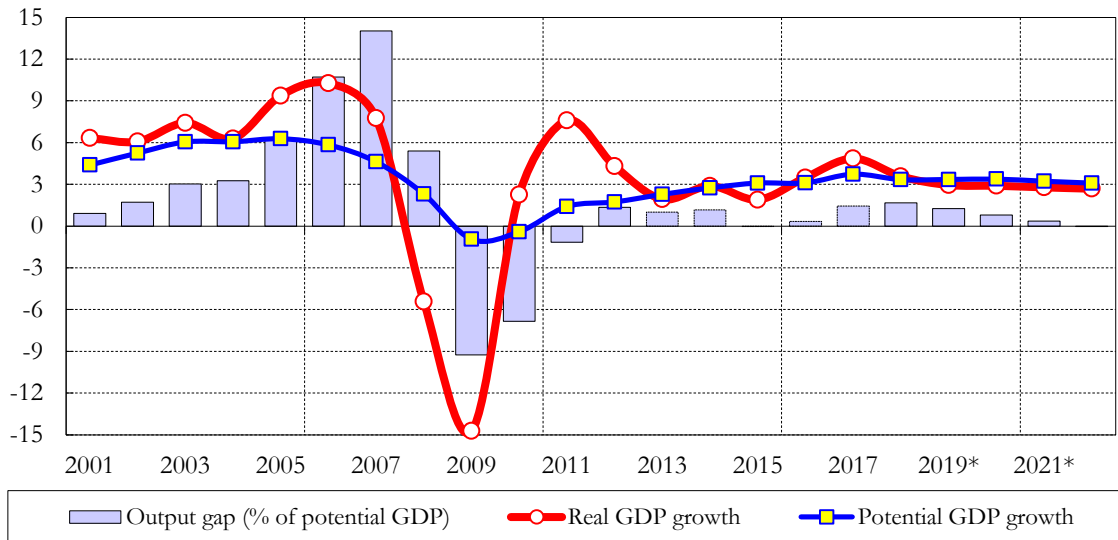
Estonia's economic growth and the change of consumer price index
(per cent)



Source: Statistics Estonia, Ministry of Finance.

Figure 2

Development of potential GDP and output gap
(per cent)



Source: Statistics Estonia, Ministry of Finance.

Table o.i) Basic assumptions

	2017	2018*	2019*
Short-term interest rate (annual average)	-0,3	-0,3	-0,2
Long-term interest rate (annual average)	0,4	0,5	0,6
USD/€ exchange rate (annual average)	0,887	0,848	0,873
Nominal effective exchange rate	-0,8	4,2	0,7
World excluding EU, GDP growth	3,9	4,1	4,0
EU GDP growth	2,4	2,1	1,9
Growth of relevant foreign markets	6,2	4,0	3,7
World import volumes, excluding EU	5,3	4,6	4,2
Oil prices (Brent, USD/barrel)	54,2	72,0	72,4

Source: Ministry of Finance.

Table 1.a. Macroeconomic prospects

	ESA code	2017	2017	2018*	2019*
		Level	rate of change	rate of change	rate of change
1. Real GDP	B1*g	19155,1	4,9	3,6	3,0
of which					
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth (1/)		-	-	-	-
2. Potential GDP			3,7	3,3	3,4
contributions:					
- labour			1,2	0,7	0,5
- capital			1,2	1,1	1,2
- total factor productivity			1,3	1,5	1,7
3. Nominal GDP	B1*g	23615,1	8,9	7,8	6,3
Components of real GDP					
4. Private final consumption expenditure	P.3	9925,5	2,6	4,1	3,9
5. Government final consumption expenditure	P.3	3429,1	0,6	0,0	0,8
6. Gross fixed capital formation	P.51	5008,3	12,5	-1,0	4,4
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	390,7	1,6	3,2	2,5
8. Exports of goods and services	P.6	16310,9	3,5	3,4	3,8
9. Imports of goods and services	P.7	15975,9	3,6	4,9	4,0
Contributions to real GDP growth					
10. Final domestic demand			4,3	1,8	3,1
11. Changes in inventories and net acquisition of valuables	P.52 + P.53		-0,4	1,9	-0,3
12. External balance of goods and services	B.11		0,1	-0,9	0,0

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 forecast.

Source: Statistics Estonia, Ministry of Finance.

Table 1.b. Price developments

	ESA code	2017	2017	2018*	2019*
		level 2010=100	rate of change	rate of change	rate of change
1. GDP deflator		123,3	3,9	3,9	3,2
2. Private consumption deflator		119,3	3,7	3,3	2,9
3. HICP		118,8	3,7	3,3	3,0
4. Public consumption deflator		136,8	6,1	7,2	7,1
5. Investment deflator		115,2	3,0	3,4	3,0
6. Export price deflator (goods and services)		110,8	3,8	1,9	1,7
7. Import price deflator (goods and services)		106,4	2,9	1,7	1,7

Source: Statistics Estonia, Ministry of Finance.

Table 1.c. Labour market developments

	ESA code	2017	2017	2018*	2019*
		Level	rate of change	rate of change	rate of change
1. Employment, persons		658,6	2,2	1,2	0,8
2. Employment, hours worked					
3. Unemployment rate (%)		40,3	5,8	5,7	6,0
4. Labour productivity, (real GDP per employed person)		29,1	2,6	2,3	2,1
5. Labour productivity, hours worked					
6. Compensation of employees	D.1	11 371,3	8,8	8,4	7,2
7. Compensation per employee		17,267	6,5	7,0	6,3

Source: Statistics Estonia, Ministry of Finance.

Table 1.d. Sectoral balances

	ESA code	2017	2018*	2019*
		% of GDP	% of GDP	% of GDP
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	4,2	3,6	3,3
<i>of which:</i>				
- balance on goods and services		4,6	3,5	3,4
- balance of primary incomes and secondary incomes		-1,4	-1,3	-1,5
- capital account		1,0	1,5	1,5
2. Net lending/net borrowing of the private sector	B.9			
3. Net lending/net borrowing of general government	B.9	-0,4	0,7	0,5
4. Statistical discrepancy		0,1	-	-

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 personnel of the Ministry. The objectivity and independence of

the forecast is assured through the transparency of forecast 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.

In annex 4 of the summer 2018 economic forecast, an analysis on the existence of systemic forecast errors was presented with the main finding that Ministry of Finance's forecast errors of macroeconomic indicators for 2014-2017 have been in comparable magnitude relative to forecast errors of the Bank of Estonia and the European Commission. When comparing these institutions' forecasts, it becomes evident that they are making similar mistakes when assessing future expectations, i.e. forecast errors are predominantly in the same direction and magnitude. This results that Ministry of Finance's forecasts for years 2014-2017 have not been systemically biased when compared with other forecasts.

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

The opinion of the Fiscal Council on the summer 2018 economic forecast of the Ministry of Finance on 19.09.2018 says:²

- „The Fiscal Council finds that the summer forecast of the Ministry of Finance describes the outlook for economic growth and inflation in Estonia accurately enough and is in line with the forecasts of several other institutions.“
- „ Tax revenues will continue to grow rapidly next year too. Receipts of labour taxes may grow even faster than expected, though the risk is greater on the downside for VAT receipts. Overall, the Fiscal Council finds that the risks of tax receipts being higher or lower than forecast are in balance and the fiscal forecast can be considered an appropriate basis for drafting the state budget for next year. “
- The Fiscal Council recommends that the 2019 state budget should be planned in a small surplus - the current high state of the economy means it is not wise to loosen the fiscal policy stance. In the summer 2018 economic forecast a 0.2% of GDP structural surplus was projected for 2018.

In the following, there are pointed out most relevant differences between Ministry of Finance's 2018 summer forecast and other institutions latest public macroeconomic forecasts. Comparing them, one should keep in mind that forecasts are compiled in different periods and therefore based on different information, which causes variations in assumptions and results of the forecasts.

² More detailed analysis is found on the web page of the Fiscal Council: https://media.voog.com/0000/0036/0984/files/2018_summer_forecast_opinion.pdf

In the beginning of this year, output expectations of different forecasters for 2018 were around 4%. After the weaker than expected Q1 GDP data, forecasters have started to revise their growth projections downwards. Forecasts for 2018, published in recent quarters, are close to 3.5%, which is in line with the expectations of the Ministry of Finance.

For 2019, forecasts are diverging more strongly. Those of published during the summer months are in between 2.7% to 3.5%. However, some of the forecasters have done upward revisions for economic growth while others have become more pessimistic. Therefore there is no consensus on economic growth forecast for 2019. When compared with the latest forecasts, Ministry of Finance's expectations are at the lower end of the forecast range.

Table 1.e. Comparison of economic forecasts

	Real GDP growth, %			Nominal GDP growth, %		
	2018*	2019*	2020*	2018*	2019*	2020*
Ministry of Finance	3,6	3,0	2,9	7,8	6,3	5,8
Bank of Estonia	3,5	3,6	2,5	7,8**	7,1**	5,8**
Swedbank	3,5	3,2	2,7	7,8**	6,8**	6,0**
SEB	3,4	3,5	2,8	-	-	-
Luminor	3,5	3,4	2,7	-	-	-
Consensus Forecasts	3,5	3,1	-	-	-	-
European Commission	3,5	2,7	-	-	-	-
IMF	3,9	3,2	3,0	8,1**	6,7**	6,5**
OECD	3,7	3,2	-	6,1**	6,1**	-
Estonian Institute of Economic Research	4,0	-	-	8,3**	-	-

	Consumer price index, % (in brackets Harmonised Consumer Price Index)			General government position, % of GDP		
	2018*	2019*	2020*	2018*	2019*	2020*
Ministry of Finance	3,3 (3,3*)	2,8 (3,0*)	2,4 (2,6*)	0,6	0,5	0,4
Bank of Estonia	2,8 (2,8*)	2,5 (2,9*)	1,9 (2,3*)	-0,5	-0,2	-0,3
Swedbank	3,4	3,0	2,5	-0,5	-0,3	-0,2
SEB	3,5*	2,5*	2,5*	-0,4	-0,7	-0,7
Luminor	3,3	2,7	2,4	-	-	-
Consensus Forecasts	3,1	2,8	-	-0,4	-0,4	-
European Commission	2,9*	2,7*	-	-	-	-
IMF	3,0*	2,5*	2,3*	-0,4	-0,2	0,0
OECD	2,8*	2,5*	-	0,4	-0,2	-
Estonian Institute of Economic Research	3,1	-	-	-	-	-

* 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. 2019 Draft Budgetary Plan of Estonia. 26.09.2018.

European Commission. European Economic Forecast. Summer 2018 (Interim). 12.07.2018.

IMF. World Economic Outlook. April 2018. 17.04.2018.

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Bank of Estonia. Monetary policy and economy. 2/2018. 26.06.2018.

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Eastern Europe Consensus Forecasts. 20.08.2018.

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. Since 2009, after the global economic crisis, the budgetary position of general government has been in a structural surplus or balance (except in 2013, 2016 and 2017 when there was deficit 0.4%, 0.1% and 0.7% of GDP).

In 2018, the structurally adjusted budgetary position of general government is projected to be balanced because of the impact of economic cycle, good tax revenue collection and modest expenditure growth. General goal of the fiscal policy is to preserve neutral or countercyclical budgetary policy. **In 2019, Estonia's general government structurally adjusted budgetary position is planned in balance, corresponding to a target set in the State Budget Strategy.** The structural balance of general government will be maintained also in coming years after which general government reaches a surplus 0.1% of GDP in 2022. There are no sustainability problems in the budget when the objectives are met. **Thus, Estonia holds its MTO during 2018-2022, which is a structural deficit up to 0.5% of GDP.**

We have maintained the structural budget balance target set in the spring, as we are confident, that it reflects Estonian fiscal position in a proper and accurate manner and it is in full compliance with national budgetary rules as well as with the provisions of the Stability and Growth Pact. Both the measures decided in the State Budget Strategy in spring and in the 2019 Draft Budget are realistic and with conservative impact assessments. In our opinion the European Commission's spring assessment on partial implementation of the revenue measures in the State Budget Strategy was not fully grounded, while it was one of the main motives for a Council's country specific recommendation to improve Estonian budgetary target set for 2019. The measures decided in the State Budget Strategy are being implemented as planned, including: the measures decided in spring are contained in the Draft Budgetary Plan for 2019 and are accompanied by draft amendments to the law, if needed; regarding the dividend revenue, the results of this year's business outcomes of the state owned companies confirm that the necessary funds are available for the planned dividend distribution in 2019; the Work Ability Reform has started successfully and actual results are in line with the expectations. We have given additional information to the Commission on the budgetary measures for 2019 and there are no unsolved issues.

According to Statistics Estonia the budgetary position of the general government was in a deficit of 0.4% of GDP or EUR 91 million in 2017. Central government and local governments were in a deficit of respectively 0.4% and 0.2% of GDP, which was partly offset by a surplus of social security funds (0.2% of GDP). Both the central government's and the local governments' deficits were mainly caused by a sharp increase in investment activity. The outcome of social security funds exceeded expectations both for the Health Insurance Fund and the Unemployment Insurance Fund; this was caused by good receipts of social tax and unemployment insurance premium.

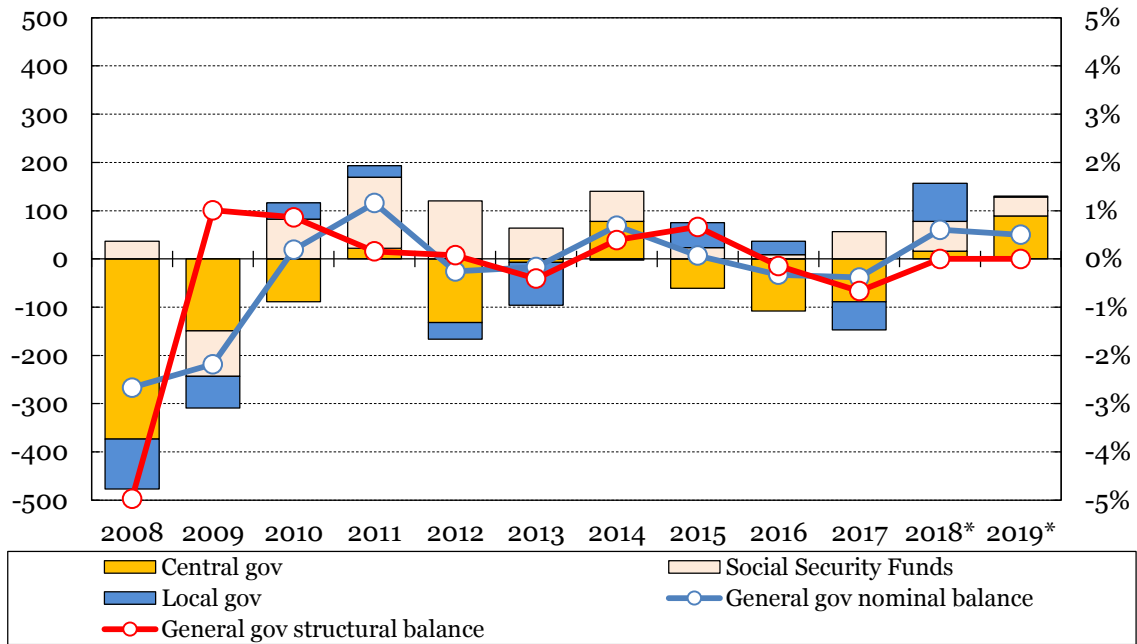
In 2018, the nominal budgetary position of general government, taking into account 2019 draft budget measures, reaches a nominal surplus of 0.6% of GDP. All levels of government are in a surplus. In 2019, according to the draft budget, the nominal budgetary position of the general government will be in a surplus of 0.5% of GDP due to additional investments, which mostly decreases the surplus of local governments.

In 2017, the general government debt decreased to 8.7 % of GDP, amounting to EUR 2 064 million. The main reason for the decline in debt burden was the faster growth of GDP compared to debt growth. Last year, the debt of local governments, public law agencies and foundations included in the central government increased nominally. This year, the debt burden of the general government can be expected to decrease to 8.1% of GDP and dropping further to 7.4% of GDP by the end of 2019.

Figure 3

General government budgetary position

(% of GDP)

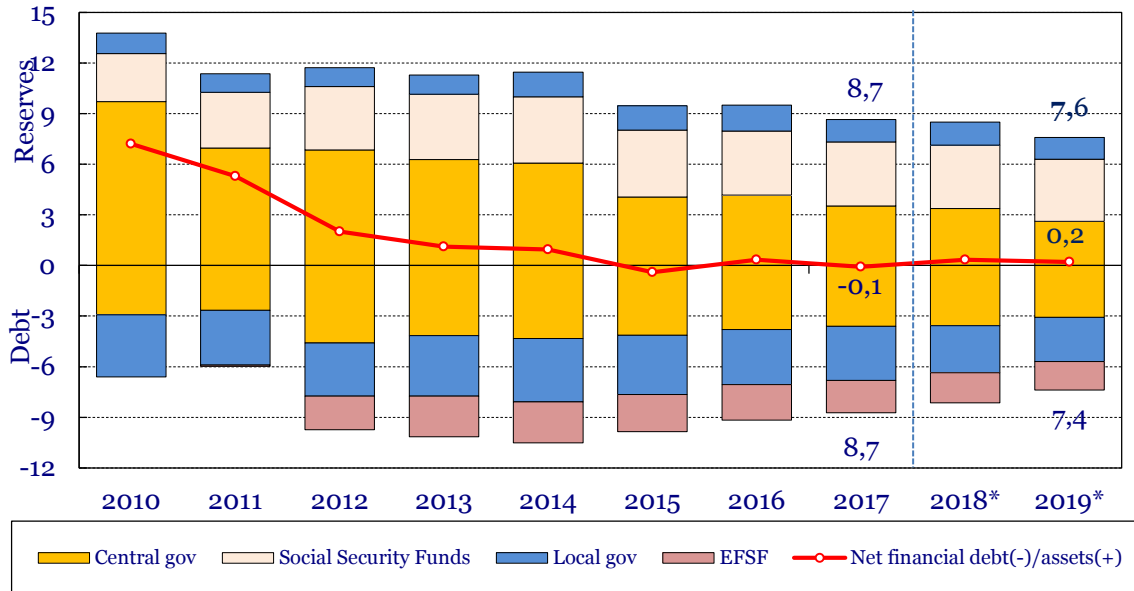


Source: Statistics Estonia, Ministry of Finance.

Figure 4

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

(% of GDP)

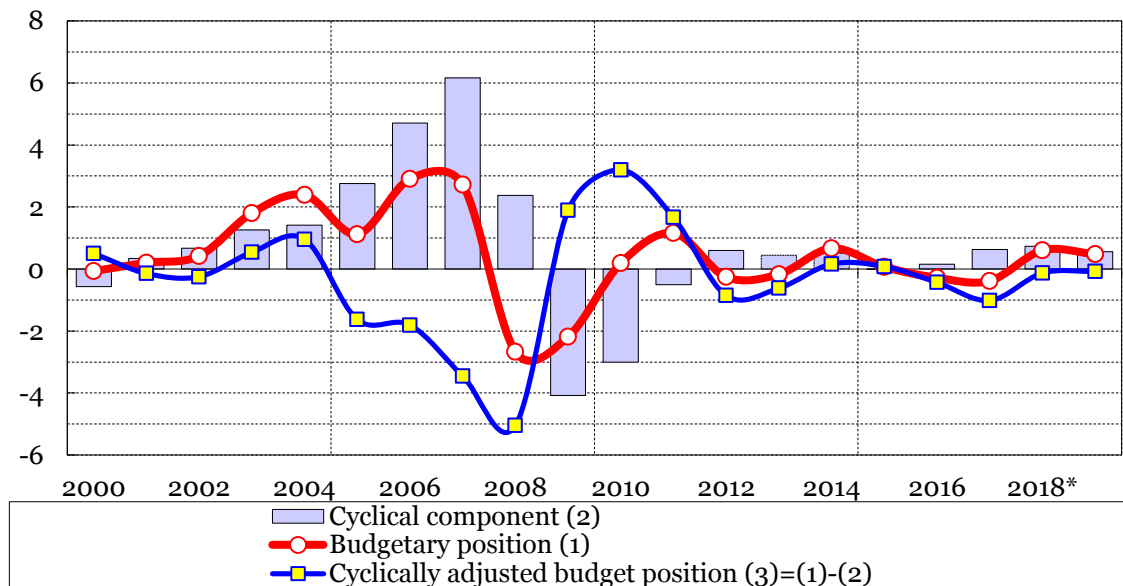


Source: Statistics Estonia, Ministry of Finance.

Figure 5

General government cyclically adjusted budgetary position

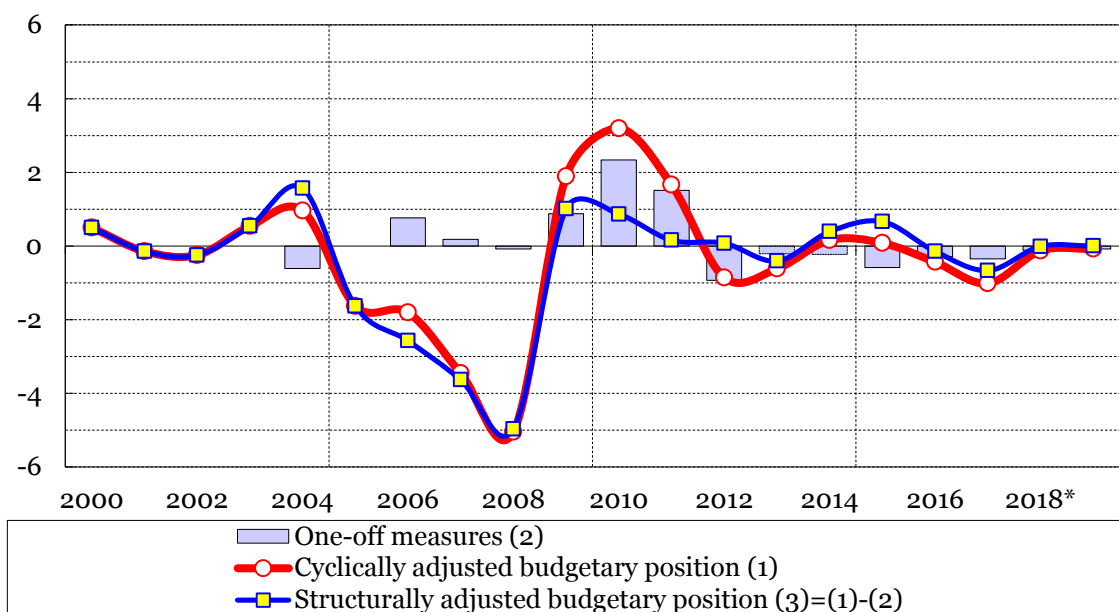
(% of GDP)



Source: Statistics Estonia, Ministry of Finance.

Figure 6**General government structurally adjusted budgetary position**

(% of GDP)



Source: Ministry of Finance.

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

	ESA code	2018 (1/)	2019*
		% SKPst	% SKPst
Net lending (+) / net borrowing (-) (B.9) by sub-sector			
1. General government	S.13	0,6	0,5
2. Central government	S.1311	0,1	0,3
3. State government	S.1312	-	-
4. Local government	S.1313	0,3	0,0
5. Social security funds	S.1314	0,2	0,1
6. Interest expenditure	D.41	0,0	0,0
7. Primary balance (3/)		0,6	0,5
8. One-off and other temporary measures (4/)		-0,1	-0,1
9. Real GDP growth (%) (=1. in Table 1a)		3,6	3,0
10. Potential GDP growth (%) (=2 in Table 1.a)		3,3	3,4
contributions:			
- labour		0,7	0,5
- capital		1,1	1,2
- total factor productivity		1,5	1,7
11. Output gap (% of potential GDP)		1,7	1,3
12. Cyclical budgetary component (% of potential GDP)		0,7	0,6
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		-0,1	-0,1
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		-0,1	0,0

15. Structural balance (13 - 8) (% of potential GDP)		0,0	0,0
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1/ According to Draft 2019 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	2018*	2019*
		% of GDP	% of GDP
1. Gross debt		8,1	7,4
2. Change in gross debt ratio		-0,6	-0,8
Contributions to changes in gross debt			
3. Primary balance (=item 10 in table 2.a.i))		0,6	0,5
4. Interest expenditure	D.41	0,0	0,0
5. Stock-flow adjustment		0,6	0,2
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/)		0,6	0,7
Other relevant variables			
6. Liquid financial assets (2/)		8,5	7,6
7. Net financial debt (7=1-6)		-0,3	-0,2
8. Debt amortization (existing bonds) since the end of the previous year ³		0,1	0,3
9. Percentage of debt denominated in foreign currency		0,0	0,0
10. Average maturity ⁴		3,2	2,7

1/ Proxied by interest expenditure divided by the debt level of the previous year.

2/ Liquid assets are here defined as F.2, F.3 (consolidated for general government, i.e. netting out financial positions between government entities), F511, F.52 (only if quoted in stock exchange), F.71.

Source: Ministry of Finance.

Table 2.c. Contingent liabilities

	2018*	2019*
	% of GDP	% of GDP
Public guarantees	9,2	8,7
Of which: linked to the financial sector	9,0	8,5

Source: Ministry of Finance.

³ Central government borrowing without foundations and legal persons governed by public law.

⁴ 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 other revenue, public gross fixed capital formation, compensation of employees and social payments. Indicators as a percentage of GDP are not directly comparable as the summer forecast ratios are based on the GDP time series revised on 31.08.2018, but in Stability Programme based on earlier GDP.

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

General Government (S13)	ESA Code	2018*	2019*
		% of GDP	% of GDP
1. Total revenue at unchanged policies	TR	41,0	41,3
of which			
1.1. Taxes on production and imports	D.2	14,2	14,5
1.2. Current taxes on income, wealth, etc.	D.5	7,6	7,3
1.3. Capital taxes	D.91	0,0	0,0
1.4. Social contributions	D.61	11,8	11,9
1.5. Property income	D.4	0,8	0,9
1.6. Other		6,6	6,7
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		33,6	33,7
2. Total expenditure at unchanged policies	TE	40,2	41,0
of which			
2.1. Compensation of employees	D.1	11,2	11,4
2.2. Intermediate consumption	P.2	6,5	6,6
2.3. Social payments	D.62 D.632	13,6	13,8
of which Unemployment benefits		0,3	0,3
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0,0	0,0
2.5. Subsidies	D.3	0,5	0,6
2.6. Gross fixed capital formation	P.51	5,8	5,9
2.7. Capital transfers	D.9	0,6	0,7
2.8. Other		1,9	2,0

Source: Ministry of Finance.

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

The Draft Budgetary Plan (Table 4.a) differs from summer forecast (Table 3) because of revenue and expenditure measures (Table 5.a). In 2018, revenue declined by 0.2% GDP mainly due to abandoning alcohol excise duty increase in 2019 and 2020. In 2019, revenue increased because of the measures by 0.1% GDP. Expenditure did not change markedly in 2018; in 2019 expenditure decreased by 0.1% GDP because of social payments.

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

General Government (S13)	ESA code	2018*	2019*
		% of GDP	% of GDP
1. Total revenue target	TR	40,9	41,4
of which			
1.1. Taxes on production and imports	D.2	14,1	14,4
1.2. Current taxes on income, wealth, etc	D.5	7,6	7,3
1.3. Capital taxes	D.91	0,0	0,0
1.4. Social contributions	D.61	11,8	11,9
1.5. Property income	D.4	0,8	0,9
1.6. Other		6,6	6,8
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		33,4	33,6
2. Total expenditure target	TE	40,3	40,9
of which			
2.1. Compensation of employees	D.1	11,2	11,4
2.2. Intermediate consumption	P.2	6,6	6,7
2.3. Social payments	D.62 D.632	13,5	13,7
of which Unemployment benefits		0,3	0,3
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0,0	0,0
2.5. Subsidies	D.3	0,5	0,6
2.6. Gross fixed capital formation	P.51	5,8	5,8
2.7. Capital transfers	D.9	0,6	0,7
2.8. Other		1,9	2,0

Source: Ministry of Finance.

In accordance with the SGP, the general government expenditure growth of a member state should conform to its GDP growth. This expenditure benchmark is usually the 10 year average potential GDP growth (in a period from t-5 to t+4) of the member state, which is 2.6% for Estonia according to the EC 2018 Spring Forecast. If the member state does not fulfil its MTO (general government deficit up to 0.5% of GDP for Estonia) for current year, the benchmark for the next will be set at a lower level (1.2% for Estonia), which will help the member state to adjust its position by at least 0,6% of GDP and fulfil its MTO.

Adjusted expenditure growth⁵ in 2018 will be 2.7%, which is almost in line with the benchmark (excess of 0.1 pp). The benchmark will also not be met in 2019, when expenditures will increase by 3.0%, exceeding the benchmark by 0.4 pps. The expected expenditure for 2018 will be somewhat smaller than was expected in the MoF spring forecast, which will increase the expected growth rate for 2019. The main reasons for this are lower than expected local government investments and social insurance expenditures. However, exceeding the expenditure benchmark will not compromise fulfilment of the MTO (-0.5% of GDP), since the state budget for 2019 is composed considering the economic cycle – structurally balanced and nominally in surplus.

Table 4.b. Expenditure benchmark

	2017	2017	2018*	2019*
	<i>level (m EUR)</i>	<i>% GDP</i>	<i>% GDP</i>	<i>% GDP</i>
1. Expenditure on EU programmes fully matched by EU funds	393,0	1,66	2,33	2,75
1a. of which investment fully matched by EU funds	199,0	0,84	0,95	1,03
2. Cyclical unemployment benefit expenditure ⁶	0,0	0	0	0
3. Effect of discretionary revenue measures ⁷	86,1 ⁸	0,36	0,68	0,41
4. General government revenue increases mandated by law	0,0	0	0	0

Source: Ministry of Finance.

⁵ In accordance with the EC methodology, real expenditure growth is used using the GDP deflator. Excluded are interest expenditure and expenditure from table 4.b, also gross fixed capital formation is smoothed over time.

⁶ Expert assessment assumption is that the level of unemployment is at its normal rate.

⁷ Included revenue measures: basic and pension income tax allowance changes; other income tax deductibility changes; company car taxation changes; income and tax from dividends; state budget wage increases; low-income tax support; distributed profit tax rate decrease (for mature companies); measure for curbing profit shifting; wage vs dividends taxation measures; entrepreneurial account for small companies; excise increases; reverse taxation of metal; VAT obligation threshold increase; fuel fraud measure; electricity excise reduction for large consumers (companies); self-employed taxation changes; CO₂ quota sales; fine increases; changes in resource charges, local government tax measure increases.

⁸ The effect of all revenue changes which applied or will apply after 01.01.2017, compared to the counter-factual. In the following years, the change of this effect is given.

Table 4.c. General government expenditures by function**Table 4.c.i) General government expenditure on education, healthcare and employment**

	2018*		2019*	
	<i>% of GDP</i>	<i>% of general government expenditure</i>	<i>% of GDP</i>	<i>% of general government expenditure</i>
Education	6,3	15,6	6,0	14,7
Healthcare	5,4	13,5	5,7	14,0
Employment	0,2	0,4	0,1	0,3

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

Functions of the Government	COFOG code	2018*	2019*
		<i>% of GDP</i>	<i>% of GDP</i>
1. General public services	1	4,0	4,4
2. Defence	2	2,2	2,2
3. Public order and safety	3	1,7	1,7
4. Economic affairs	4	4,7	4,9
5. Environmental protection	5	0,5	0,4
6. Housing and community amenities	6	0,3	0,3
7. Health	7	5,4	5,7
8. Recreation, culture and religion	8	1,9	1,9
9. Education	9	6,3	6,0
10. Social protection	10	13,3	13,4
11. Total expenditure (=2. in Table 4.a)	TE	40,3	40,9

Source: Ministry of Finance.

5. Description of discretionary measures included in the draft budget

There are nine measures that have an impact on state budget revenue and expenditure in 2019. Four of them have an impact on state budget revenue, five of them affect state budget expenditure. All expenditure measures (total of EUR 26.7 million) are temporary in nature and they are used to cover the priority needs of the ministries.

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	
					2018*	2019*
					% of GDP	% of GDP
1) Dividend shift	Moving dividends to 2019, with additional income tax (CIT)	Revenue, D421, D5	Accrual method	Draft is not required	-0,03	0,05
2) The sales of CO ₂ quotas	The sale of greenhouse gas emission allowances for the period 2013-2020 within the EU	Revenue, D7	Accrual method	Draft is not required	0,00	0,13
3) Abandoning alcohol excise duty increase	Abandoning alcohol excise duty increases in 2019 and 2020	Revenue, D2	Accrual method	Submitted with budget	-0,13	-0,10
4) Other expenses	Revenue from new traffic cameras and frequency permissions, the sale of lands and the introduction of income-based fines	Revenue, D7, D2, D61	Accrual method	Draft is not required	0,00	0,03
5) Social contribution measures	Specification of the forecast of Work Ability Reform	Expenditure, P62	Accrual method	Draft is not required	0,05	0,11
6) Real estate investments	Rescheduling and reestimation of transactions	Expenditure, P51	Accrual method	Draft is not required	0,00	0,08
7) Expenses from CO ₂ quotas sales	Expenses for climate policy goals, energy efficiency and renewable energy measures, for alternative fuels usage in transport	Expenditure, P51	Accrual method	Draft is not required	0,00	-0,06
8) Operating cost savings	Transfer of specified budget excess 1% instead of 3%	Expenditure, P2	Accrual method	Submitted with budget	-0,07	0,07
9) Other different expenditure measures	Funds allocated to different ministries, airport measure, purchase of traffic cameras	Expenditure, P2	Accrual method	Draft is not required	0,00	-0,10
Total revenue measures					-0,16	0,11
Total expenditure measures					-0,03	0,10
TOTAL					-0,18	0,21

Source: Ministry of Finance.

Table 5.b. Discretionary measures taken by Central

List of measures	Detailed description	Target (exp / rev component) ESA Code	Accounting principle	Adoption status	Budgetary impact	
					2018*	2019*
					% of GDP	% of GDP
1) Dividend shift	Moving dividends to 2019, with additional income tax (CIT)	Revenue, D421, D5	Accrual method	Draft is not required	-0,03	0,05
2) The sales of CO ₂ quotas	The sale of greenhouse gas emission allowances for the period 2013-2020 within the EU	Revenue, D7	Accrual method	Draft is not required	0,00	0,13
3) Abandoning alcohol excise duty increase	Abandoning alcohol excise duty increases in 2019 and 2020	Revenue, D2	Accrual method	Submitted with budget	-0,13	-0,10
4) Other expenses	Revenue from new traffic cameras and frequency permissions, the sale of lands and the introduction of income-based fines	Revenue, D7, D2, D61	Accrual method	Draft is not required	0,00	0,03
5) Social contribution measures	Specification of the forecast of Work Ability Reform	Expenditure, P62	Accrual method	Draft is not required	0,05	0,11
6) Real estate investments	Rescheduling and reestimation of transactions	Expenditure, P51	Accrual method	Draft is not required	0,00	0,08
7) Expenses from CO ₂ quotas sales	Expenses for climate policy goals, energy efficiency and renewable energy measures, for alternative fuels usage in transport	Expenditure, P51	Accrual method	Draft is not required	0,00	-0,06
8) Operating cost savings	Transfer of specified budget excess 1% instead of 3%	Expenditure, P2	Accrual method	Submitted with budget	-0,07	0,07
9) Other different expenditure measures	Funds allocated to different ministries, airport measure, purchase of traffic cameras	Expenditure, P2	Accrual method	Draft is not required	0,00	-0,10
Total revenue measures					-0,16	0,11
Total expenditure measures					-0,03	0,10
TOTAL					-0,18	0,21

Source: Ministry of Finance.

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

In this chapter information is presented on how the measures in the draft budget plan take into account the country-specific recommendations (CSRs) and contribute to Europe 2020 objectives for growth and jobs.⁹

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

Table 6.a. Country-specific recommendations

CSR no	List of measures	Description of direct relevance
1.	1.1 Ensure that the nominal growth rate of net primary government expenditure does not exceed 4.1% in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP.	<p>The draft 2019 Budget Plan targets structural balance and nominal surplus. Budgetary measures planned in the State Budget Strategy are being implemented according to initial plans. General government expenditure increase in 2019 is affected by the following factors:</p> <ul style="list-style-type: none"> • an upward revision of budget balance in 2018 by 0.5% of GDP in nominal and by 0.4% of GDP in structural terms when compared to the Stability Programme; • postponement of local government capital expenditure from 2018 to 2019 (growth in 2019 17.2%, i.e. EUR 164 million); • the negative effect from local government administrative reform on expenditure in 2018; • lower than expected expenditure of Social Security Funds in 2018.
1.	1.2 Improve the adequacy of the social safety net, in particular for older people and people with disabilities. Take measures to reduce the gender pay gap, including by improving wage transparency in the private sector.	<p>For improving the adequacy of the social safety net, in particular for older people and people with disabilities:</p> <ol style="list-style-type: none"> 1. Pension indexation with an index of 1,076 in 2018, resulting in average pension increase from EUR 415.6 to EUR 446.5. According to the forecasts, pension index of 1,078 is expected in 2019 and average pension raises to EUR 480.4. 2. Starting from 2018, additional bonus to the pension is paid to the mothers and fathers in amount of EUR 6.161 per child. This additional bonus is being paid to 229'000 pensioners. 3. Continuation of support for a pensioners living alone, that started in 2017. In 2018, a pensioner living alone receives additional one-time benefit of EUR 115 per annum if the monthly pension is below EUR 492. In October 2018 this benefit is paid to 79'370 pensioners. The relative poverty rate of pensioners living alone is expected to reduce by 5.5 percentage points due to this benefit (the relative poverty rate before and after the

⁹ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2018:320:FULL&from=EN>

		<p>benefit).</p> <ol style="list-style-type: none"> 4. Annual benefit of repressed persons was increased from EUR 192 to EUR 230 in 2018. Repressed persons' benefit receivers are pension-aged persons, mostly. 5. The basic income tax allowance was increased to EUR 500 per month. 6. Benefit for persons with reduced capacity for work was indexed with pension index (1.076) in 2018, which increased the average benefit for persons with partial capacity for work from EUR 202.2 to EUR 217.51 and the average monthly benefit for persons without capacity for work increased from EUR 354.6 to EUR 381.6. According to the forecasts, indexation with 2019 pension index (1.078) increases benefit for persons with partial capacity for work to EUR 234.3 and for persons without capacity for work to EUR 411.3 per month. 7. The subsistence level for the first household member was increased to EUR 140 per month in 2018. <p>For reducing the gender pay gap, including for improving wage transparency in the private sector:</p> <ol style="list-style-type: none"> 1. On 23. August 2018 the Government adopted amendments to the Gender Equality Act, which creates more efficient system for analysing gender pay gap and helps employers to analyse wages of women and men with more efficient and convenient solutions. The Labour Inspectorate is given a right to exercise over implementation of the requirement of equal pay for women and men for the same work and work of equal value in the public sector. The draft law has passed first reading in the Parliament. 2. According to the draft law, private sector employers can use digital solutions for finding out gender pay gap in their organisation and use support and help of Labour Inspectorate for the following steps. The draft law is expected to be enforced on 1. July 2020. <p>In addition to the abovementioned, over the years the Ministry of Social Affairs has organised several awareness-increasing trainings for the private sector employers, has trained consultants specialised in gender equality and who would consult employers free of charge (with the support of ESF) and published different thematic information materials.</p> <p>Gender Equality Council is an advisory body supporting the Government, and in recent years they have repeatedly pointed out a glass ceiling effect and the need to increase the share of women in managerial level and among the decision makers, which contributes to decreasing gender pay gap.</p> <p>Increased number of referrals to gender equality and equal treatment commissioner points to increased awareness among employees.</p>
2.	Promote research and innovation, in particular by providing effective incentives for broadening the innovation base.	<p>In addition to the measures implemented earlier years, in 2018 the following actions were taken:</p> <ol style="list-style-type: none"> 1. Starting from September 2018 product development support is provided to manufacturing companies, which encourages them to invest into development process. Increased value added and sales revenue from new products is expected from the measure.

		<ol style="list-style-type: none"> 2. For companies, needs-based research and development capacity development sectoral programmes in the field of ICT and resource valuation have been launched. 3. Transfer support scheme is in preparation, where scientists can develop their scientific results into the form that is needed for the business sector (so-called proof of concept support). Expected launch time is 2nd half of 2019. 4. Preparations for becoming a full member of the European Organization for Nuclear Research (CERN) are ongoing. This is needed for Estonian companies to fully benefit from the opportunities provided by CERN. 5. A comprehensive analysis of the tax system is conducted for improving business and innovation friendliness of the tax environment, including for promoting entrepreneurship with high value added and high knowledge intensity.
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Table 6.b. Targets set by the Union's Strategy for growth and jobs

National 2020 headline targets	List of measures	Description of direct relevance to address the target
National employment target [76%]	1. Maintaining work capacity	<p>Modernisation of health and safety regulation, including health inspection, staff mentoring and training, and first-aid management. Modern and clear regulation of occupational health and safety helps preventing work-related health damage and supports preservation of work capacity of employees in the working environment.</p> <p>The amendments were adopted in 2018 and will come into force in 2019.</p> <p>Redesigning occupational health and safety regulation, including the legal clarity of the teleworking requirements for occupational health and safety, which can have a positive effect on employment if employers are more willing to provide teleworking by bringing those workers to the labour market for whom it is important to perform duties outside the employer's premises (e.g. for better combining work- and family life or workers in regions where daily commuting may be difficult).</p> <p>During summer-2018, the intention of drafting the Draft Law on the Amendment to the Employment Contracts Act and the Occupational Health and Safety Act was sent to the of interest groups and ministries for collecting opinions. Based on the received feedback, consultations with stakeholders will continue.</p> <p>Discussions on possible changes to the employment relationship regulation are ongoing and they cover the flexibility of working and leisure time, work place and fixed-</p>

		<p>term employment contracts and the extension of social guarantees to persons engaged in work.</p> <p>The intention of drafting the Draft Law on the Amendment to the Employment Contracts Act and the Occupational Health and Safety Act was sent out to the interest groups and ministries in summer 2018 for collecting opinions. Based on the received feedback, consultations with stakeholders will continue.</p>
	2. Increasing employability of youth	<p>Matching learning opportunities with the needs of the labour market. Reforming the career services system and improving access to career services, including career counselling for young people, to support them in making informed choices about career and education.</p> <p>Implementation of the Youth Guarantee Program, including the provision of “My First Job”, with the aim of fostering the recruitment of young people and, thus, reducing youth unemployment and carrying out labour market introductory workshops in order to raise young people's professional awareness.</p> <p>Development and implementation of a Youth Guarantee Support System for supporting inactive young people to help them continue their education, increase their employability and involve them into the labour market.</p> <p>Supporting activities that increase competitiveness and enable the young people aged 16-26 to participate in the Open Call for Proposals.</p> <p>Increasing working opportunities for minors via minor employability support in order to promote creation of work experience.</p>
	3. Implementing Work Ability Reform	<p>Creating a system for assessing work capacity, providing services for the target group, and data exchange solutions necessary for service implementation.</p>
	4. Implementation of the employment programmes	<p>Providing active labour market measures. Employment programmes create conditions for piloting services in addition to the ones constituted in the Labour Market Services and Benefits Act.</p> <p>Since May 2017 Employment programmes provide unemployment prevention measures. These measures provide opportunities for specific employees for upskilling via labour market trainings or level educations. In addition, employers can apply for training support for hiring employees in the areas with labour shortages or related to restructuring of</p>

		<p>businesses.</p> <p>Paying out job creation support from Employment programmes will be continued till end 2018 for those employers who applied for it before end-2017. The job creation support is paid to Ida-Virumaa employers who employed at least 20 unemployed persons during two months over the period from May 2016 until end-2017. A total of 645 jobs were created in 17 companies.</p> <p>As a new service, starting from 1 January 2019, support for creating a regional job will be provided in Ida-Virumaa and South-Eastern Estonia, where unemployment is higher than the Estonian average. The support consists of wage subsidies and reimbursement of training expenses. The measure is funded by the European Social Fund, with a total cost of EUR 1.48 million over three years. In total, creation of around 360 jobs will be supported during this period.</p>
National R&D target [3% of GDP]	In addition to the activities described last year, several new initiatives can be outlined:	
	1. Product development support for manufacturing companies (starting from September 2018).	The support is intended to encourage industry to invest more into development. Business value added and sales turnover from new products should increase.
	2. For companies, needs-based research and development capacity development sectoral programmes in the field of ICT and resource valuation have been launched.	The capacity of research institutions to carry out the research needed for companies, to prepare labour force with better knowledge and skills is growing. As a result, research directions in the interests of companies arise in research institutions. The ICT program was launched in 2018, the resource valuation program will start in 2019.
	3. Supporting applied research in the area of smart specialisation supports cooperation of enterprises and research institutions.	Through this measure, companies can share risks with the state in ordering knowledge intensive applied research and product development from R&D institutions in. Positive experience provides additional development boost for further R&D investments.
	4. Transfer support scheme is in preparation, where scientists can develop their scientific results into the form that is needed for the business sector (so-called proof of concept support). Expected launch time is 2nd half of 2019.	At the end of the research work, the results are usually not sufficiently mature for developing business solutions. Further research is needed in order to develop the research results in an attractive form for companies. Transfer support offers researchers this opportunity. The ERC Proof of Concept support was analogous to the support scheme.
	5. Since 2019 in the calculation of basic financing	The state promotes cooperation of research institutions with enterprises and creates an

	the basic financing of research institutions and the share of business contracts in the formula for the allocation of base financing has increased.	additional incentive for business co-operation through the growth in the share of entrepreneurship contracts and the increase in base financing. In the long run, this should lead to an increase in private sector R&D expenditure.
	6. Preparations for becoming a full member of the European Organization for Nuclear Research (CERN) are ongoing.	This is needed for Estonian companies to fully benefit from the opportunities provided by CERN. Opportunities for R&D and increasing competitiveness are increasing.
	7. Developing a joint strategy for R&D, innovation and entrepreneurship in co-operation with the Ministry of Education and Research and Ministry of Economic Affairs and Communication by 2021.	Planning a joint strategy in the field of entrepreneurship, R&D and innovation will help to better align various measures towards common goals and ensure better synergy between the measures.
GHG emission reduction target [6,024 thousand tons (+11% compared to 2005)]	1. Implementation of the new National Development Plan of the Energy Sector until 2030.	1. The National Development Plan of the Energy Sector is based on ensuring that consumers have a supply of reasonable priced and affordable energy to make environmental impacts acceptable and in line with the long-term energy and climate policy of the European Union. By 2030, electricity production from renewable energy sources will account for 50% of the final consumption of domestic electricity; through the reconstruction activities, the energy efficiency of buildings has increased (40% for small houses = C or D energy efficiency class; from apartment buildings 50% = C; non-residential buildings 20% = C); new buildings correspond to the energy efficiency value of the near-zero energy building; 37% of the total net area of buildings occupied by the central government is located in buildings that meet at least the minimum energy performance requirements that came into force in 2013
Renewable energy target [25%]		
National energy efficiency target [2 818 ktoe]	2. Implementation of the fundamentals of climate policy until 2050.	2. According to the fundamentals of climate policy, Estonia has a long-term goal of moving to a low-carbon economy, which means gradually transforming the economy and energy system into more resource-efficient, productive and greener. By 2050, Estonia intends to reduce greenhouse gas emissions by nearly 80 percent compared to 1990 level.
	3. Preparation of a national	3. Based on the Energy Sector Development Plan and the basics of climate policy, an

	<p>energy and climate plan</p> <p>4. Implementation of Structural Funds measures</p>	<p>Energy and Climate Plan is being prepared, which will agree on the goals of the reduction of greenhouse gas emissions and energetics goals in Estonia and outlines with what measures they are intended to be achieved. The initial version of the plan is ready and it is in its first consultation round. The plan is expected to be submitted to the European Commission for review in December 2018.</p> <p>4. Structural funds will support the reconstruction of the apartment building stock; the construction of more efficient heat generating capacities and pipelines in the district heating sector or the renovation of existing ones and the replacement of district heating with local heating solutions of renewable energy sources; in reconstruction of street lighting systems using complex LED lighting technology; in the transport sector, the intention is to increase the share of alternative fuels by supporting the development of biomethane production and refuelling infrastructure, and activities to ensure the use of produced biomethane in transport.</p>
<p>Reducing the number of young persons with basic education level or lower who are not studying [9,5%]</p>	<p>1. Flexible learning possibilities and support systems in vocational education</p>	<p>On 26 September 2018, a draft amendment to the Vocational Educational Institutions Act was approved at the Government of the Republic of Estonia, which, among other things, regulates:</p> <ul style="list-style-type: none"> - Implementation of a career choice curriculum (previous name: year of orientation) - Legitimising of non-stationary general education in vocational education institutions (i.e. the possibility for adults to acquire only secondary education at a vocational school similar to the adult upper secondary school) - Development of a system for supporting pupils in a vocational school - Upgrading the organisation of learning for students with special educational needs (amendment of the Regulation of the Minister of Education and Research, in proceedings). <p>In addition, the following is under development:</p> <ul style="list-style-type: none"> - Additional training for graduates from the national curriculum for the basic school; - Applying “Taking account of previous studies and work experience” in elementary and upper secondary schools (incl. advising and

		encouraging schools); - Increasing the flexibility of curricula and school management for basic and upper secondary schools.
	2. Academic and career counselling	Implementation of academic and career counselling system in basic schools, upper-secondary schools and vocational schools.
	3. Inclusive education and co-learning school	Introduction of principles for inclusive education, according to which pupils with special educational needs are firm and inseparable part of school pupils, they are involved in learning activities according to their capability, and they get sufficient support for learning and coping. A co-learning conception will be composed for supporting the schools where children with different cultural background must learn together.
National target for tertiary education [40%]	1. One of the six indicators of higher education performance financing is the share of graduates with a nominal length.	The share of graduates with nominal length is monitored separately as a performance indicator to motivate universities to reduce the number of students in discontinuation of education. When allocating the benefit, it is assessed how many graduates from the students have completed within the nominal study period and the universities with better results receive higher share of performance financing.
	2. Means-tested education allowance and special support for students who need the most support. Specialty scholarships for NS and other important fields in the country.	Different allowances and grants for students supporting non-dropouts are also important
National poverty target [15%]	1. Raising child benefits	From the beginning of 2018, child allowances for first and second child increased to EUR 55 per month and in 2019 will increase to EUR 60 per month. If triplets or more multiple children are born in the family at the same time, the state will pay a supplement to their family from 1 March 2018. The amount of support is 1000 euros per family per month and we pay it until the children reach the age of 18 months.
	2. Parental benefit changes	Related to the increase of the minimum wage, the minimum rate of parental benefit has constantly increased in recent years. In 2017, the minimum parental benefit was 430 euros, in 2018 it was 470 euros and in 2019 it will be 500 euros. Also, the flexibility for receiving parental benefit at the same when the parent is working,

		has been increased. From 1 March 2018, the income threshold was raised from which the parental benefit would be reduced when working receiving a parental benefit simultaneously.
	3. Changes in subsistence benefit	<p>From January 2018, the subsistence level for the first member of the household was increased to EUR 140 per month. The coping rate for each child of the family increased to 120% of the subsistence level of the first member of the family (or EUR 168 in 2018).</p> <p>All child allowances are considered as income in the calculation of subsistence benefit. The need-based family allowance regulation became void.</p> <p>In order to increase the motivation for work, wage income is not considered to be part of the household income in subsistence benefit calculations and wage income is deducted from the income by 100% for first 2 months and by 50% for consecutive 4 months if the person has received subsistence benefits without labour income for at least the previous two consecutive months.</p> <p>The income earned by a person in a basic school, upper secondary school or a vocational education with non-completed secondary education level until the age of 19 years or after the age of 19 until the end of the current academic year or the exclusion from the school's list is not considered to be family income.</p> <p>From the beginning of 2018, municipalities will be able to take into account the amount of housing costs that are unavoidable and arising from legislation or because of risks to human health or life in deciding subsistence benefits for households who have been receiving subsistence benefit for at least six months in succession.</p>
	4. Pension increase and increase in basic income tax allowance.	Pensions are increasing and the payment of additional support to retired persons living alone will continue in order to improve coping of pensioners. From the beginning of 2018, the basic income tax allowance was increased to EUR 500 per month.

7. Divergence from the latest Stability Programme

Estonia's State Budget Strategy 2019–2022 and Stability Programme 2018 was based on the spring forecast of the Ministry of Finance, published on 16 April 2018. The 2019 State budget is based on the summer economic forecast, published on 11 September 2018.

According to the spring forecast of the Ministry of Finance **economic growth** for 2018 was expected to be 4.0%. During 2019–2020 we expected the growth rate 3.2% and 3.0%, respectively. This year's economic growth forecast has been reduced by 0.4 percentage points compared to the spring forecast and is now 3.6%. Export is growing slower than previously expected, while domestic demand and import growth will be somewhat faster, which may result in a negative contribution from net exports. The forecast for 2019-2020 has been reduced by 0.2 and 0.1 percentage points compared to the spring forecast. Both domestic demand and export and import growth have been revised downwards. The biggest downward correction is in the increase in exports, which is why the contribution of net exports may be lower than previously expected. Expectations of rising prices are more optimistic than expected in the spring for the whole forecast period. The adjustment of GDP growth and price increases led to an increase in the nominal growth forecast for this year. The nominal economic growth expectations for 2019-2020 have not changed.

The contribution of **domestic demand** to growth in 2018 will be broadly like forecast a year before, but the composition is different. Investment is weaker, but change in inventories compensates the decline of new investment in the corporate sector. Private consumption growth will be weaker in 2018, but stronger in 2019, as a significant share of wage earners decided not to benefit from the income tax reform from the beginning of 2018 but rather get the tax refund next spring. Investment growth in 2018 is expected to be lower than expected in spring, as cautious behaviour continues and the rapid growth of business investment in 2017 resulted from a few large scale projects in some narrow field of activities.

The risk of trade barriers with growing uncertainties in trade is showing up in more modest foreign demand. In addition, decline in export orders of electronics has continued. As a result of this, forecast of **exports** has been cut by 1.1 pps in 2018 and by 0.4 pps in 2019. Imports will grow faster than expected in the previous forecast due to stronger imports of capital goods and robust imports of services.

HICP inflation forecast is 0.3 pps in 2018 and 0.5 pps in 2019 higher compared to the stability programme. Upward revision of the forecast in 2018 is due to higher energy prices. In 2019, in addition to energy prices, draught is pushing food prices higher as well.

Labour market developments in the first half of 2018 have been slightly more positive than expected in the spring forecast as employment increased more than expected. At the same time unemployment rate was in line with expectations. Although the quarterly results from the Labour Force Survey have wide confidence bounds and thus are volatile, these developments are confirmed by the data from the Tax Board and the Unemployment Insurance Board. In addition, preliminary results from the Work Ability Reform are showing better than expected effect on employment, while the negative effect on unemployment remained modest. This results that despite efforts made by the Unemployment Insurance Fund within the reform, many of the persons with partial ability for work are becoming or remain discouraged. However, those who are actively searching for job opportunities can find work more easily than expected.

Wage growth was slower than expected during first half of this year. Wage growth decelerated in the second quarter, but it was most likely affected by behavioural change due to the income tax reform where the pattern of+ taking out holiday pays changed. People have changed their preference in taking out the holiday pay from advance payments to regular payments during normal wage pay out days to maximise monthly available basic tax allowance – this changed wage bill dynamics within the year. Wage growth expectations for future years have been reduced due to changes in economic growth forecast.

The general government budgetary position in 2018 has improved by 0.4% of GDP compared with the spring forecast and is now expected to be in a surplus of 0.6% of GDP. The improvement comes from all levels of governments and is caused primarily by better than expected tax revenue. The general government nominal budget projection for 2019 has remained at the same level (0.5% of GDP) compared to the Stability Programme.

In 2018, the tax burden forecast compared to the Stability Programme has been revised downwards by 0.9 pps to 33.4% of GDP. Tax revenue increased because of PIT and VAT and decreased due to alcohol excise duty and CIT; the main driver of tax burden change was an upward correction of GDP. In 2019, the tax burden is expected to decrease by 1.0 pps to 33.6% of GDP. Tax revenues increased because of VAT, revenue from the sale of emission permits and PIT; revenue decreased due to alcohol excise duty, CIT and social tax; as in 2018 the main driver of change was an upward correction of GDP.

Forecast of general government debt has been decreased by 0.4% of GDP in 2018 and by 0.3% of GDP in 2019, respectively, compared to the forecast included in the Stability Programme due to an upward correction of GDP.

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

	ESA code	2017	2018*	2019*
		% of GDP	% of GDP	% of GDP
General government structural balance (1/ target)	B.9			
Stability Programme		-0,3	-0,4	0,0
Draft Budgetary Plan		-0,7	0,0	0,0
Difference		-0,4	0,4	0,0
General government structural balance projection at unchanged policies	B.9			
Stability Programme		-0,3	-0,4	0,0
Draft Budgetary Plan		-0,7	0,2	-0,2
Difference		-0,4	0,6	-0,2

1/ Budgetary position is targeted by structural balance.

Source: Statistics Estonia, Ministry of Finance.

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

	ESA code	2017	2018*	2019*
		<i>% of GDP</i>	<i>% of GDP</i>	<i>% of GDP</i>
General government net lending/ net borrowing target	B.9			
Stability Programme		-0,3	0,2	0,5
Draft Budgetary Plan		-0,4	0,6	0,5
Difference		-0,1	0,4	0,0
General government net lending/ net borrowing projection at unchanged policies	B.9			
Stability Programme		-0,3	0,2	0,5
Draft Budgetary Plan (1/)		-0,4	0,8	0,3
Difference		-0,1	0,6	-0,2

1/ Actual (t-1) and summer forecast (t, t+1).

Source: Statistics Estonia, Ministry of Finance.

8. Distributional effects of main revenue and expenditure measures

Gini coefficient¹⁰ for Estonia, which indicates the income distribution of the population (larger index denominates larger inequality), was 35.6% in 2014, which was the highest in the EU. Since 2015, the index for Estonia has greatly improved and was 31.6% in 2017. The shift is large and with this Estonia has surpassed 8 countries regarding this indicator. However, the 2017 Gini coefficient is not available for some of the countries and thus for the EU average at the time of this writing. The EU average was 30.8% in 2016. Although Estonia is likely not far from the average, inequality is still large compared to our northern neighbours, the Nordic countries. However, comparing countries with very different sizes and development stages might yield misleading results, since regional inequality in larger countries might be less noticeable for their inhabitants.

In 2018, a large income tax allowance increase came into force, which should improve the Gini coefficient by about 0.1 points. This impact assessment is based on a study¹¹ which looked at the Estonian tax burden distribution by income using the microsimulation model EUROMOD. Since the allowance affects most of the population, it can increase the relative poverty rate. Other revenue and expenditure measures planned for 2019, which could theoretically change the distribution of income (like excise increases), will most likely not have a noticeable effect in the context of Gini coefficient in 2019.

¹⁰ Eurostat, EU-SILC – Gini coefficient of income after social transfers.

¹¹ Praxis. (Only in Estonian) Maksupoliitika mõju leibkondade maksukoormuse jaotumisele: https://www.rahandusministeerium.ee/system/files_force/document_files/2016-praxis_maksukoormuse_raport_10nov.pdf?download=1