EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 20 May 2020

Assessment of the 2020 Stability Programme for

Estonia

(Note prepared by DG ECFIN staff)

CONTENTS

Executive Summary

- On 6 April 2020, the Commission provided guidelines to the Economic and Financial Committee on how the format and content of the 2020 Stability and Convergence Programmes can be streamlined in light of the exceptional circumstances related to the Covid-19 pandemic. This assessment takes into account the severe constraints that Member States faced in providing the information usually required in their Programmes. The assessment focuses on the near term in light of the high uncertainty attached to the projections.
- The Stability Programme is based on the Ministry of Finance macroeconomic forecast from end March, which did not yet take account of the softening impact of the fiscal stimulus package. It projects real GDP to fall by 8% in 2020 and to increase by 8% in 2021. The Commission spring 2020 forecast takes into account the fiscal stimulus measures and expects GDP to decline less, by 6.9% in 2020, and to rebound by 5.9% in 2021.
- The Stability Programme's fiscal forecast expects Estonia's general government deficit to reach 10.1% of GDP in 2020. The Commission spring forecast projects a lower general government deficit of 8.3% of GDP in 2020, but the forecasts are not directly comparable due to the differences in the underlying macroeconomic scenarios.
- The crisis-related fiscal measures amount to 4.3% of GDP and include raising healthcare-related spending, tax deferrals and cuts, a two-month wage subsidy scheme and investment programmes. Various smaller measures are targeted to specific sectors, such as shipping, education, and culture. Additional liquidity and loan measures amount in total to 8.7% of GDP. Broadly, the package of measures adopted and implemented in Estonia is considered appropriate.
- The macroeconomic and fiscal outlook is affected by high uncertainty due to the COVID-19 pandemic.

1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2020 Stability Programme[1] of Estonia covering the period 2020-2021 (hereafter called the Programme), which was submitted on 28 April 2020[2]. The note also assesses Estonia compliance with the preventive arm of the Stability and Growth Pact in 2019. Estonia is currently subject to the preventive arm of the Stability and Growth Pact (SGP).

The Programme was prepared by the Ministry of Finance based on the 2020 supplementary budget documentation and the programme was subsequently not formally discussed and approved by the government. The Programme states that the Government is going to have a look at the medium term plans in the autumn, along with making the draft 2021 Budget.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit the activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Estonia is among those Member States that have triggered national escape clauses to suspend budgetary constraints set by their national fiscal rules, as part of the effort to accommodate the budgetary implications of the outbreak.

2. MACROECONOMIC DEVELOPMENTS

The macroeconomic forecast underlying the Stability Programme

Estonia entered the pandemic crisis from an economic peak, with a real GDP growth of 4.3% in 2019. On 13 March 2020, the Estonian government declared a state of emergency. All schools and universities were closed and all public gatherings

[1] The Stability Programme submitted by Estonia does not indicate that it also constitutes the national medium-term fiscal plan required under Article 4(1) of Regulation 473/2013.

[2] The Stability Programme contains only short-term budgetary projections, in line with the guidelines for a streamlined format of the 2020 Stability and Convergence Programmes in light of the COVID-19 outbreak, provided by the Commission services on 6 April 2020.

banned, including sports and cultural events. While shopping malls were closed, other shops, restaurants, industry and banks have remained open.

The macroeconomic scenario underlying the Stability Programme was developed on 31 March and does not yet take the stimulus measures into account (which were passed by the Parliament at a later date). The difference with the Commission projections notably reflects the earlier publication date of the Ministry of Finance's macroeconomic forecast, which did not yet take account of the stimulus programme. The Ministry later added the total cost of the stimulus programme on top of the earlier forecast without updating the macroeconomic forecast and without taking account of the positive feedback loop back to the fiscal forecast in the form of fiscal revenues. Therefore, the Programme's and Commission's forecasts are not directly comparable.

The Programme forecast is based on the assumption that the severe restrictive measures on the economy would be lifted in end-May and thereafter a gradual pickup in economic activity would begin. The real GDP is forecast to fall by 8% in 2020 and to increase by 8% in 2021. The pace of recovery is assumed to be heterogeneous across economic sectors, but in the aggregate reaching about 90% level of nominal GDP trend growth in 2021. According to the Stability Programme, the Estonian economy will be primarily hit by the fall in foreign demand, which will weigh on exports. Private consumption is expected to contract by over 11% in 2020, while the impact on investment will be less pronounced.

The Commission spring 2020 forecast, which takes into account the softening impact of the fiscal stimulus measures, expects real GDP to decline by 6.9%, and to rebound by 5.9% in 2021. The Commission spring forecasts assumes a somewhat bigger drop in investment than the Stability Programme, in line with the expected contraction in the export markets, and a somewhat lower fall of private consumption in 2020 due to the stimulus. Still, overall, both the macroeconomic scenario in the Programme and in the Commission forecast assume a broadly comparable rebound and expect fundamentals to remain relatively strong. Inflation projections do not differ much between the two forecasts, and inflation is forecast to moderate to around 0.5% in 2020 and to pick up to around 2% in 2021.

Prior to the publication of the Stability Programme, the Fiscal Council of Estonia (*Eelarvenõukogu*)[3] published on 15 April 2020 its opinion on the macroeconomic forecast of the Ministry of Finance, which also underlies the later Stability Programme. The Fiscal Council considered the macroeconomic forecast overall plausible, while noting the high uncertainty related to the duration of the pandemic. Since the forecast extends only to 2021, the Fiscal Council highlighted the importance that the Government presents by autumn a longer-term perspective of public finance, together with steps to return the budget to balance.

[3] http://eelarvenoukogu.ee/en

Table 1: Comparison of macroeconomic developments and forecasts

	2019		2020		2021		2022	2023
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	4.3	4.3	-6.9	-8.0	5.9	8.0	n.a.	n.a.
Private consumption (% change)	3.1	3.1	-7.2	-11.3	7.1	8.9	n.a.	n.a.
Gross fixed capital formation (% change)	13.2	13.1	-8.7	-5.7	6.3	5.6	n.a.	n.a.
Exports of goods and services (% change)	4.9	4.9	-12.5	-12.3	8.5	12.0	n.a.	n.a.
Imports of goods and services (% change)	3.7	3.7	-10.8	-14.4	7.2	12.8	n.a.	n.a.
Contributions to real GDP growth:							n.a.	n.a.
- Final domestic demand	5.2	5.2	-4.9	-7.0	4.4	5.7	n.a.	n.a.
- Change in inventories	-0.2	-0.3	-0.4	-2.3	0.4	1.7	n.a.	n.a.
- Net exports	1.0	1.0	-1.6	0.9	1.1	0.2	n.a.	n.a.
Output gap[1]	4.3	3.5	-5.3	-6.4	-3.0	-2.4	n.a.	n.a.
Employment (% change)	1.3	1.0	-5.7	-8.2	3.7	2.8	n.a.	n.a.
Unemployment rate (%)	4.4	4.4	9.2	12.5	6.5	9.5	n.a.	n.a.
Labour productivity (% change)	3.0	3.3	-1.4	0.2	2.1	5.0	n.a.	n.a.
HICP inflation (%)	2.3	2.3	0.7	0.5	1.7	2.2	n.a.	n.a.
GDP deflator (% change)	3.2	3.2	1.7	0.4	2.0	2.3	n.a.	n.a.
Comp. of employees (per head, % change)	7.8	8.0	2.0	-1.5	2.7	7.0	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	3.8	3.1	3.8	5.9	4.9	5.2	n.a.	n.a.

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2020 spring forecast (COM); Stability Programme (SP).

3. Recent and planned budgetary developments

3.1. Deficit and debt developments and Medium-term strategy and targets[4]

In 2019, the general government deficit in Estonia reached 0.3% of GDP, while the structural balance stayed unchanged. This outcome is somewhat weaker than expected in the Draft Budgetary Plan from autumn 2019, which expected a balanced budget of 0.0% of GDP in nominal terms (and an improvement of the structural balance of 0.9% of GDP). The higher than expected deficit mainly arises from higher current expenditures (and also a revised output gap for the structural balance).

In 2020, based on the plans in the Stability Programme, Estonia's general government deficit is expected to reach 10.1% of GDP, reflecting the stimulus package of 4.3% of GDP and automatic stabilisers. The deficit is mainly caused by lower tax revenue, reflecting the economic crisis, the estimated impact of various tax deferral measures (lowering interest rates and rescheduling tax liabilities) and lowering energy excises. The biggest growth of expenditure comes from the Health Insurance Fund and the Unemployment Insurance Fund. State budget expenditures are much less affected by COVID-19. Investments and operational costs are not expected to change notably and social expenditures, such as pensions, are indexed with last year figures. The Commission spring forecast includes the impact of automatic stabilisers and takes account of the same stimulus measures as the Stability Programme and projects a lower general government deficit of 8.3% of GDP in 2020 but, as explained above, the forecasts are nevertheless not directly comparable due to the difference of the underlying macroeconomic scenarios.

The Stability Programme's horizon extends until 2021. The Programme projects the deficit to decline to 3.8% of GDP in 2021, when the economy is expected to recover and most of the budgetary measures are expected to expire. It is a no-policy-change projection and does not include any possible post-crisis fiscal rectification measures. The Commission spring forecast projects a general government deficit of 3.4% of GDP in 2021.

Estonia's general government gross debt stood at 8.4% of GDP in 2019. Reflecting the rise in the deficit and the various guarantee schemes of the government, debt is forecast to rise to 23.4% of GDP by 2021 according to the Stability Programme, and 22.6% of GDP according to the Commission spring forecast.

[4] In light of the activation of the general escape clause, the measures taken in response to the coronavirus outbreak in 2020 are not treated as one-off and are thus not excluded from the estimation of the structural budget balance.

Table 2: General government budgetary position

(% of GDP)	2019	2020		2021		2022	2023	Change: 2019-2023
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	**38.7**	**38.7**	**39.2**	**39.0**	**38.7**	**n.a.**	**n.a.**	**n.a.**
of which:						n.a.	n.a.	**n.a.**
- Taxes on production and imports	14.1	13.2	13.3	13.4	13.1	n.a.	n.a.	**n.a.**
- Current taxes on income, wealth, etc.	7.3	7.2	7.0	7.2	7.1	n.a.	n.a.	**n.a.**
- Social contributions	11.9	12.0	12.2	12.3	12.4	n.a.	n.a.	**n.a.**
- Other (residual)	5.5	6.3	6.7	6.0	6.1	n.a.	n.a.	**n.a.**
Expenditure	**39.0**	**47.0**	**49.3**	**42.4**	**42.5**	**n.a.**	**n.a.**	**n.a.**
of which:						n.a.	n.a.	**n.a.**
- Primary expenditure	39.0	47.0	49.2	42.3	42.4	n.a.	n.a.	**n.a.**
of which:						n.a.	n.a.	**n.a.**
Compensation of employees+Intermediate consumption	18.0	20.0	20.7	18.8	18.3	n.a.	n.a.	**n.a.**
Compensation of employees	11.5	12.5	13.5	12.1	11.9	n.a.	n.a.	**n.a.**
Intermediate consumption	6.5	7.5	7.1	6.7	6.4	n.a.	n.a.	**n.a.**
Social payments	13.5	16.3	16.6	15.1	14.4	n.a.	n.a.	**n.a.**
Subsidies	0.4	1.3	0.4	0.5	0.4	n.a.	**n.a.**	**n.a.**
Gross fixed capital formation	4.9	5.6	6.3	5.5	5.8	n.a.	n.a.	**n.a.**
Other (residual)	2.3	3.7	5.3	2.4	3.6	n.a.	n.a.	**n.a.**
- Interest expenditure	0.0	0.0	0.1	0.0	0.1	n.a.	n.a.	**n.a.**
General government balance (GGB)	**-0.3**	**-8.3**	**-10.1**	**-3.4**	**-3.8**	**n.a.**	**n.a.**	**n.a.**
Primary balance	**-0.3**	**-8.3**	**-10.1**	**-3.3**	**-3.7**	**n.a.**	**n.a.**	**n.a.**
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	n.a.	n.a.	**n.a.**
GGB excl. one-offs	**-0.3**	**-8.3**	**-10.1**	**-3.4**	**-3.8**	**n.a.**	**n.a.**	**n.a.**
Output gap[1]	4.3	-5.3	-6.4	-3.0	-2.4	n.a.	n.a.	**n.a.**
Cyclically-adjusted balance[1]	-2.4	-5.8	-7.3	-1.9	-2.7	n.a.	n.a.	**n.a.**
Structural balance[2]	**-2.4**	**-5.8**	**-7.3**	**-1.9**	**-2.7**	**n.a.**	**n.a.**	**n.a.**
Structural primary balance[2]	-2.4	-5.8	-7.2	-1.9	-2.6	n.a.	n.a.	**n.a.**
Gross debt ratio	**8.4**	**20.7**	**21.9**	**22.6**	**23.4**	**n.a.**	**n.a.**	**n.a.**

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability Programme (SP); Commission 2020 spring forecasts (COM); Commission calculations.

3.2. MEASURES UNDERPINNING THE PROGRAMME

The measures presented in the Stability Programme are based on the Supplementary Budget 2020 that was adopted by the parliament on 16 April 2020. The fiscal cost of the measures amount to EUR 1.15 bn, or 4.3% of GDP, including the calculated fiscal deficit effect (losses) of liquidity and loan measures (see Table 3 below). The liquidity and loan measures amount in total to EUR 2.25 bn, or 8.7% of GDP[5], and are designed to provide loan guarantees for already issued bank loans, operating loans, investment loans to take advantage of new business opportunities, and additional financial measures for rural and agricultural businesses. Both the Stability Programme and the Commission forecast include a same estimate that a part of the announced large liquidity measures (guarantees and loans) will lead to losses and increase the government deficit. This reflects the standardised nature of the instruments and past practices applied by the national statistical authorities.

The largest fiscal measures include the raising of healthcare-related spending, rescheduling and lowering interest rates on tax liabilities, 70% wage subsidy scheme for 2 months, additional funding for local governments, and specific investment programmes (housing insulation and road construction). Various smaller measures are targeted to specific sectors, such as shipping, education, and culture.

Overall, the measures taken by Estonia are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak[6]. The measures appear timely, temporary and targeted at cushioning the shock induced by COVID-19. The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term.

[5] The Stability Programme describes the guarantee and loan measures and specifies their estimated impact on the general government deficit (see Table 3 below), but neglects to include numerical information on the total amounts of these measures. However, as this information is detailed in the 2020 supplementary budget (which underlies the Programme) the current assessment presents the figures from that document.

[6] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020DC0112.

Table 3: Discretionary measures adopted/announced in response to COVID-19 outbreak

List of measures	Description	ESA Code (Expenditure / Revenue component)	Adoption Status	Budgetary impact (% of GDP - change from previous year)		
					2020	2021
Tax deferral	Reduction of the interest rate on tax arrears rescheduling up to 100% instead of 50%	D.2	adopted		-0.5%	0.8%
Tax deferral	Suspension of calculation of interest on tax debt for two months	D.2	adopted		0.0%	0.0%
Tax deferral	Reduction of tax interest from 0,06% to 0,03% until end 2021	D.2	adopted		0.0%	0.0%
Social tax	The state pays the advance payment of social tax for self-employed persons for the first quarter of 2020.	D.62+D.63+D.621+D.624+D.631	adopted		0.0%	0.0%
Social tax	Temporary cancellation of social tax minimum for employers for three months	D.62+D.63+D.621+D.624+D.631	adopted		0.0%	0.0%
Reduction of energy excise duties	diesel, liquid gas, natural gas, electricity	D.2	adopted		-0.3%	-0.2%
Forest sales income tax credit	Forest sales income tax credit	D.5	adopted		0.0%	0.0%
VAT reduced rate for digital publications	VAT reduced rate of 9% for digital publications	D.2	adopted		0.0%	0.0%
Second pillar pension funds	Temporary suspension of contributions to the second pillar pension funds	D.62+D.63+D.621+D.624+D.631	adopted		0.5%	-0.1%
Local government investments	Local government support measure	P.51: Gross fixed capital formation	adopted		-0.3%	0.3%
Education	Private schools, private interest education, private kindergartens, private childcare	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.1%	0.1%
Investment to science	Construction of the third level biolab of the University of Tartu	P.51	adopted		0.0%	0.0%
Culture	State support measure for culture and sports, including partial compensation of direct costs of canceled events	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.1%	0.1%
Shipping	Support scheme for passenger ships	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		0.0%	0.0%
Shipping	Exemption of waterway charges for ships entering the port for 1 year	D.2	adopted		-0.1%	0.0%
Shipping	Reimbursement of 75% of all types of port dues for passenger ships by 2020	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.1%	0.1%
Strategic companies, capital injections	Support purchases of shares in strategic companies or capital expansion of state-owned companies	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.1%	0.1%
Construction	Demolition of abandoned houses	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		0.0%	0.0%
Construction	Renovation support measure for apartment buildings and private houses via Kredex	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.4%	0.3%
Construction	Reconstruction of local government and Road Administration roads	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.1%	0.0%
micro and small business capital injections	Based on EAS activities, design a micro and small business measure through capital injections	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		0.0%	0.0%
tourism sector (grant scheme)	Based on EAS activities, operating support measure in the tourism sector (grant scheme)	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.1%	0.1%
Broadband	Broadband Access Networks for sparsely populated areas	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.1%	0.1%
Loan guarantees	Loan guarantees for bank loans already issued in order to allow for repayment schedule adjustments (Kredex)	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.4%	-0.2%
Operating loan	Operating loan granted by KredEx up to 20 mln €;	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.2%	-0.1%
Investment loan	Investment loan granted by KredEx up to 20 mln €; Loan granted by KredEx for nationally important projects pver 20 mln €	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91): Other	adopted		0.0%	0.0%
Wage subsidy	Unemployment Insurance Fund measure for labor market support within 2 months (wage support measure)	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-1.0%	0.9%
State reimbursement of sick days	State reimbursement of sick days for workers from the first to the third day of sickness insurance (currently without pay) from March to May 2020	D.62+D.63+D.621+D.624+D.631	adopted		0.0%	0.0%
Pparents of children with special educational needs	Additional funds for Social Insurance Board to provide care certificate for parents of children with special educational needs	D.62+D.63+D.621+D.624+D.631	adopted		0.0%	0.0%
Disability assessments	Automatic extension of ability to work and severity of disability assessment	D.62+D.63+D.621+D.624+D.631	adopted		0.0%	0.0%
Loan guarantees, agriculture	Alleviating liquidity shortages for micro, small and medium-sized enterprises and large enterprises	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.1%	0.1%
Operating and investment loans, agriculture	Alleviating liquidity shortages for micro, small and medium-sized enterprises and large enterprises	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.1%	0.1%
Arable land sale and lease-back transactions	Improving access to capital for micro, small and medium-sized enterprises	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		0.0%	0.0%
Replacement service for farmers	Replacement service for farmers, covers operating costs	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		0.0%	0.0%
Churches and congregations	Support of operating costs of churches and congregations	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		0.0%	0.0%
COVID-19 reserve	The decisions in connection with COVID -19 costs will be made on an ongoing bases	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.3%	0.3%
Government reserve	The decisions will be made on an ongoing bases	P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)	adopted		-0.6%	0.5%
				Total	-4.4%	3.1%

Source: Stability Programme

Table 4: Guarantees adopted/announced in response to COVID-19 outbreak

List of measures	Description	Adoption Status	Maximum amount of contingent liability (% of GDP)	
Loans and guarantees through the Rural Development Foundation	Agriculture sector loans and guarantees	adopted		**0.8%**
Guarantees and loans via Kredex Estonia	Loan guarantees for bank loans already issued, operating loans, investment loans	adopted		**7.9%**
			Total	**8.7%**

Source: Stability Programme and 2020 supplementary budget

3.3. RISK ASSESSMENT

The risks to the Programme's budgetary projections appear broadly balanced. The Commission spring forecast (although not directly comparable to the Ministry of Finance forecast, as explained above) projects a smaller budget deficit than the Ministry of Finance for 2020 and in 2021 as it takes into account the positive effect of the stimulus measures on the economy.

The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. The pandemic could become more severe and last longer than assumed, requiring more stringent and longer lasting containment measures. This would result in worse economic and fiscal outcomes. It could also require further fiscal policy measures. That would result in worse fiscal outcomes but help to mitigate the economic impact. An additional risk stems from the considerable size of public guarantees provided in response to the crisis. The possible need for additional measures has been discussed by the government (although currently without concrete plans), and such measures would add to the deficit. The Estonian Fiscal Council warns that the worsening of tax discipline is an additional negative risk.

In its assessment of the Ministry forecast, the Fiscal Council concluded that the general government did not meet its own domestic fiscal rules in 2019, nor in 2018. The emergency has suspended the fiscal rules for 2020.

Overall, the previously rigorous fiscal discipline has slackened in Estonia over the past years. The government has not yet announced plans on how to rectify the fiscal position and return to the fiscal rules in 2021.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

4.1. COMPLIANCE WITH THE DEFICIT CRITERION

According to the Stability Programme, Estonia's general government deficit is expected to reach 10.1% of GDP in 2020, thereby exceeding the Treaty reference value of 3% of GDP. This provides prima facie evidence of the existence of an excessive deficit in Estonia for the purposes of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU, which analyses Estonia's compliance with the deficit criterion of the Treaty. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

4.2. COMPLIANCE WITH THE MTO OR THE REQUIRED ADJUSTMENT PATH TOWARDS THE MTO IN 2019[7]

Estonia was recommended to ensure that the nominal growth rate of net primary government expenditure does not exceed 4.1% in 2019 ('the expenditure benchmark'), corresponding to a structural adjustment of 0.6% of GDP. Based on the outturn data and on the Commission forecast, the growth of primary government expenditure, net of discretionary revenue measures and one-offs, exceeded that benchmark. This led to a deviation of 1.7% of GDP in the underlying fiscal position, thus pointing to a significant deviation from the recommended adjustment path towards the MTO in 2019 and over 2018-2019 taken together. In turn, the structural balance stayed unchanged in 2019, thus pointing to some deviation by 0.3% of GDP from the recommended structural adjustment of 0.6% of GDP towards the MTO in 2019, while pointing to significant deviation over 2018-2019 taken together. The structural balance is to a significant extent impacted positively by revenue windfalls in 2019, reflecting the especially strong accrual of labour and consumption taxes during the good economic times that prevailed in 2019. The expenditure benchmark is thus considered to appropriately reflect the underlying fiscal effort of Estonia. The overall assessment points to significant deviation from the recommended adjustment path towards the MTO in 2019.

[7] The possible retroactive impact on output gap estimates as a result of the recession induced by the COVID-19 outbreak and the possibility of abnormal responses of government revenues to major swings in economic activity underline that compared to the structural balance the expenditure benchmark is likely to provide a more reliable and predictable indicator in times of severe economic downturn.

Table 5: Compliance with the requirements under the preventive arm

	(% of GDP)	2019	2020		2021	
	Background budgetary indicators[1]					
(1)	Medium-term objective (MTO)	-0.5	-0.5		-0.5	
(2)	Structural balance[2] (COM)	-2.4	-5.8		-1.9	
	Setting the required adjustment to the MTO					
(3)	Structural balance based on freezing (COM)	-1.6				
(4) = (1) - (3)	Position vis-a -vis the MTO[3]	Not at MTO				
(5)	Required adjustment[4]	0.3				
(6)	Required adjustment corrected[5]	0.3				
(8)	Corresponding expenditure benchmark[6]	4.9				
	Compliance with the required adjustment to the MTO					
		COM	COM	SP	COM	SP
	Structural balance pillar					
(8) = Δ (2)	Change in structural balance[7]	0.0				
(9) = (8) - (6)	*One-year deviation from the required adjustment*[8]	-0.3				
	Two-year average deviation from the required adjustment[8]	-0.3				
	Expenditure benchmark pillar					
(10)	Net public expenditure annual growth corrected for one-offs[9]	9.8				
(11) = (10) - (8)	One-year deviation adjusted for one-offs[10]	-1.7				
	Two-year deviation adjusted for one-offs[10]	-1.2				
	Finding of the overall assessment	**Significant deviation**				

Legend

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[7] Change in the structural balance compared to year t-1. Ex post assessment for 2019 is carried out on the basis of Commission 2020 spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

[11] Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (S/CP) budgetary projections for the previous years are achieved.

[12] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[13] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[14] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

Source :
Stability Programme (SP); Commission 2020 spring forecast (COM); Commission calculations.