RAHANDUS-
MINISTEERIUM
MINISTRY of FINANCE of the REPUBLIC of ESTONIA

2025 Draft Budgetary Plan of Estonia

Tallinn, 15. October 2024

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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 takes place every autumn. 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 Estonian medium-term Fiscal-Structural plan.

The Fiscal-Structural Plan was approved by the Government on 10 October 2024. **The draft 2025 State Budget with explanatory memorandum was approved on 25 September in the meeting of the Government and it was given for proceeding to Parliament.**

The draft 2025 State Budget of the Republic of Estonia is based on State Budget Strategy 2025–2028, The Government's Action Programme and the planned activities take into account the Government's Action Programme and The European Commission and the Country Specific Recommendations as adopted by the Council in June. In the formulation of the fiscal policy, national requirements and the Stability and Growth Pact requirements on the budgetary policy of the EU Member States are being respected.

1. Macroeconomic forecast

The Draft 2024 State Budget of the Republic of Estonia is based on the summer forecast of the Ministry of Finance (MoF), published on 27 August 2024. Assumptions of the forecast were fixed in mid-August 2023. Economic forecasts of the Ministry of Finance are public and can be found from the web page of the Ministry (https://www.fin.ee/riigi-rahandus-ja-maksud/fiskaalpoliitika-ja-majandus/rahandusministeeriumi-majandusprognoos).

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According to the forecast, the economy will return to growth by the end of 2024, but we still see a 1% decline annually in 2024. In the spring and early summer of 2024, there were no strong signs of a significant increase in economic activity. Therefore, in the summer forecast, we expect economic growth to start later in the year. Over the next couple of years, real economic growth will recover close to 2-3%, supported by improvements in the industrial, construction, and service sectors.

The expected recovery in external demand in the second half of 2024 will also be reflected in the recovery of Estonia's export volumes. In 2023, Estonia's exports decreased significantly. The reasons for this were the relatively weak economic conditions in Estonia's export markets, the rising cost levels for Estonian exporters, the loss of imported eastern raw materials, and the decline in transit trade. For the 2024, we expect a slight decline in exports, although it will turn to growth in the second half of the year. A stronger recovery in exports can be expected next year. Export volumes could return to 2022 levels, that is, pre-decline levels, by 2027.

The increase in purchasing power, the recovery of consumer confidence, and the reduction of interest payments will boost private consumption. In 2024, income growth will clearly exceed price increases, and interest payments will begin to decline, creating conditions for private consumption growth. However, private sector investments are awaiting a more significant improvement in economic conditions. The recovery of export markets and falling interest rates should restore normal investment levels from 2025 onwards.

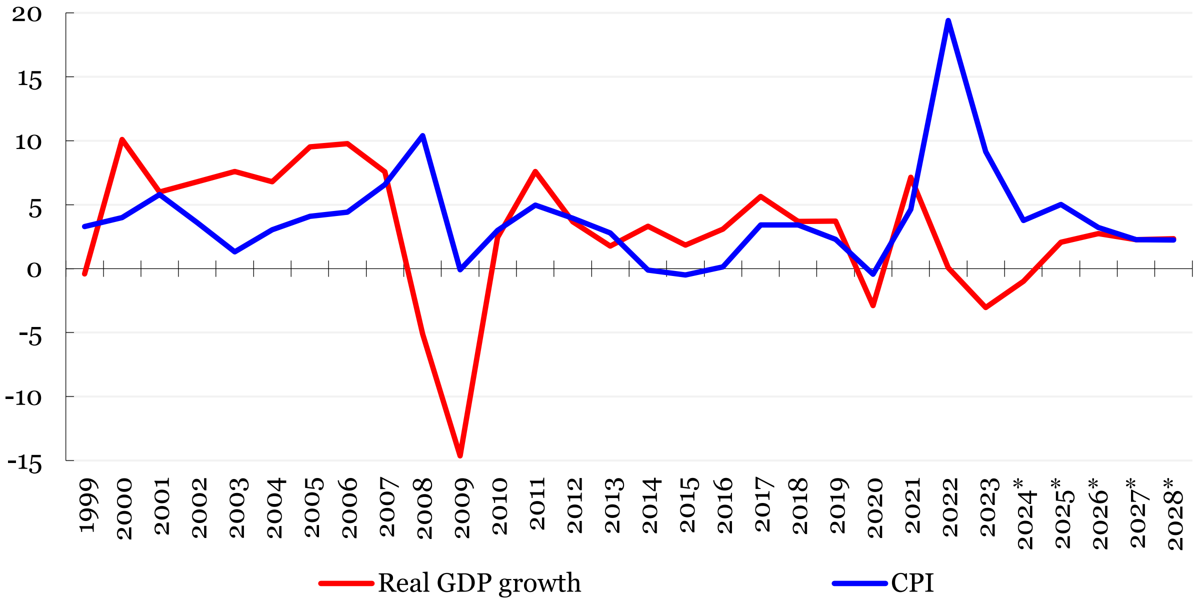
External and domestic factors, as well as indirect tax hikes, will lead to a slight acceleration of consumer price increases next year. The trend of slowing inflation, which characterised the first half of 2024, has now come to an end, with the 2.5% low of inflation in June. In the autumn, consumer price increases may accelerate due to the diminishing impact of falling energy prices, the expected economic recovery, and rising raw food market prices. In 2025-26, the introduction of the car tax, VAT increase and excise hikes will temporarily accelerate inflation. In the following years, inflation is expected to stabilise around 2%.

Major layoffs are behind us, but the peak of unemployment could still occur by the end of this year. Companies' growth expectations and for hiring new employees have slightly improved in recent months, but remain historically low, so we still see a small increase in unemployment by the end of this year, partly due to seasonal factors. The labour market has been relatively favourable due to companies retaining employees to be ready for the next growth cycle. Thus, if economic growth gradually recovers from the second half of this year, employment could start increasing with a significant delay, only by mid-2025. In the longer term, further employment growth will be constrained by the already high participation rate and a shortage of skilled labour. Therefore, we do not foresee an increase in the number of employees from 2027 onwards. Unemployment is projected to stabilise near its natural level, around 6%, by the end of the forecast period.

Wage pressures are decreasing along with the slowdown in price increases. Due to easing inflationary pressures and slowing revenue growth, private sector wage growth subsided over the past year and reached around 6-7% by early summer 2024. According to the forecast, wage growth will slow further, reaching just over 5% in the second half of this year.

Figure 1

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



Source: Statistics Estonia, Ministry of Finance.

Table 0.i) Basic assumptions

	2023	2024*	2025*
Short-term interest rate (annual average)	3,4	3,6	2,4
Long-term interest rate (annual average)	2,5	2,4	2,4
USD/€ exchange rate (annual average)	1,082	1,085	1,091
Nominal effective exchange rate	4,1	0,9	-0,1
World excluding EU, GDP growth	3,1	3,2	3,3
EU GDP growth	0,4	0,8	1,5
Growth of relevant foreign markets	-1,3	0,9	3,1
World import volumes, excluding EU	0,2	2,7	3,4
Oil prices (Brent, USD/barrel)	82,6	82,6	76,5

Source: Eurostat, Bank of Estonia, European Central Bank, IMF, U.S. Energy Information Administration, Consensus Economics, European Commission, Chatham Financial, Bloomberg and NYMEX Brent futures, Ministry of Finance.

Table 1.a. Macroeconomic prospects

		2023 Level	2023 rate of change	2024 rate of change	2025 rate of change
1. Real GDP	B1*g	28961,3	-3,0	-1,0	2,1
of which					
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth (1/)					-1,2
2. Potential GDP			1,8	0,2	0,8
contributions:					
- labour			2,3	0,6	0,5
- capital			1,7	1,4	1,4
- total factor productivity			-2,2	-1,8	-1,2
3. Nominal GDP	B1*g	38182,3	4,8	2,7	6,2
Components of real GDP					
4. Private final consumption expenditure	P.3	14889,9	-1,5	0,5	-0,8
5. Government final consumption expenditure	P.3	5919,3	0,9	0,9	-0,5
6. Gross fixed capital formation	P.51	8588,3	7,6	-1,5	4,1
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53		-0,2	-0,8	-0,5
8. Exports of goods and services	P.6	22171,1	-9,0	-0,2	3,4
9. Imports of goods and services	P.7	23198,4	-6,7	1,3	2,1
Contributions to real GDP growth					
10. Final domestic demand			1,5	0,1	0,7
11. Changes in inventories and net acquisition of valuables	P.52 + P.53		-2,9	0,0	0,4
12. External balance of goods and services	B.11		-2,0	-1,1	1,0

1/ This estimate includes the effect of 2025 budgetary consolidation measures on economic growth in relation to the no-policy-change forecast.

Source: Statistics Estonia, Ministry of Finance.

Table 1.b. Price developments

	ESA code	**2023** *level 2010=100*	**2023** rate of change	**2024*** rate of change	**2025*** rate of change
1. GDP deflator		153,7	8,1	3,7	3,7
2. Private consumption deflator		149,1	8,8	3,7	4,2
3. HICP		149,6	9,1	4	4,1
4. Public consumption deflator		165,2	11,4	5,9	3,3
5. Investment deflator		127,6	5,7	4,4	2,9
6. Export price deflator (goods and services)		140,7	3,6	1,5	2,6
7. Import price deflator (goods and services)		131,5	-1,5	1,6	2,6

Source: Statistics Estonia, Ministry of Finance.

Table 1.c. Labour market developments

	ESA code	2023	2023	2024*	2025*
		Level	*rate of change*	*rate of change*	*rate of change*
1. Employment, persons		694,6	2,5	0,0	0,2
2. Employment, hours worked			2,5	0,0	0,2
3. Unemployment rate (%)		47,7	6,4	7,7	7,5
4. Labour productivity, (real GDP per employed person)		41,7	-5,4	-1,0	3,1
5. Labour productivity, hours worked			-5,4	-1,0	3,1
6. Compensation of employees	D.1	18899,3	10,4	5,5	5,2
7. Compensation per employee		27,2	7,6	5,5	5,0

Source: Statistics Estonia, Ministry of Finance.

Table 1.d. Sectoral balances

	ESA code	2023	2024*	2025*
		% of GDP	*% of GDP*	*% of GDP*
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	-0,2	-0,3	-0,5
of which:				
- balance on goods and services		0,8	-0,4	-0,1
- balance of primary incomes and secondary incomes		-2,2	-1,9	-2
- capital account		1,1	2	1,6
2. Net lending/net borrowing of the private sector	B.9			
3. Net lending/net borrowing of general government	B.9	-2.4	-2.7	-3.0
4. Statistical discrepancy		-0,5	-	-

Source: Statistics Estonia, Ministry of Finance.

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Economic forecast of the Ministry of Finance is prepared by analysts from the Fiscal Policy Department, who belong to the personnel of the Ministry. The objectivity and independence of the forecast is assured through the transparency of forecasting process, the involvement of different external economists and through continuous comparison of forecasting results and regular analysis of forecasting errors. Before finalisation of the forecast of the Ministry of Finance, its main assumptions and results are 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. 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.

The opinion of the Fiscal Council on the summer 2024 macroeconomic forecast of the Ministry of Finance

Pursuant to §18 of the State Budget Act, the Fiscal Council issued its opinion on the summer 2024 economic forecast of the Ministry of Finance on 10 September.[1]

In its September 10 opinion, The Fiscal Council endorsed the summer forecast 2024 of the Ministry of Finance and considers it a suitable basis for the state budget and the budget strategy that are to be drafted this autumn. The summer forecast of the Ministry of Finance does not yet contain a scenario that presents the most probable development of the Estonian economy and public finances for the years ahead. The coalition agreement scenario considers the measures from the summer's coalition agreement that will increase revenues and cut spending (and their impact on key macroeconomic indicators), but does not yet consider planned increases in spending on national defence and security. In addition, the Fiscal Council has a different estimate from the Ministry of Finance for the output gap, which is the difference between the actual and potential levels of the economy, and the source of the difference is how shocks to the Estonian economy and high inflation have impacted the output gap.

The Ministry of Finance agrees with this assessment.

The impact of fiscal measures on economic development

The planned fiscal consolidation measures decided in autumn 2024 during the preparation of Draft 2025 State Budget and the 2025-2028 State Budget Strategy are expected to affect the outlook for Estonia's economic development. The measures considered for example, impact household net incomes, prices, and GDP. The measures are estimated to reduce real GDP growth by about 1.2 percentage points in 2025, 0.3 percentage points in 2026, 0.2 percentage points in 2027, and 0.1 percentage points in 2028. Consumer price increases will accelerate by 0.8 percentage points next year and by 1 percentage point in 2026 due to increases in VAT and excise duties.

The analysis examines a selection of funding sources, which are provisionally divided into four groups: 1) increases in standard VAT rate and excise duties; 2) changes related to the taxation of household incomes (postponement of the unified tax-free basic allowance to 2026 and the taxation of household incomes as part of the security tax); 3) taxation of companies as part of the security tax; and 4) cuts in government sector operating and labour costs.

We assess the impact of defence investments and the acquisition of ammunition stocks on the Estonian economy to be marginal, as these are likely to be largely imported and will not affect the domestic value added. The estimated role of different types of measures in the change of real GDP compared to the Ministry of Finance's summer baseline forecast is shown in the figure below. The changes in the taxation of private incomes have the largest negative impact on economic growth.

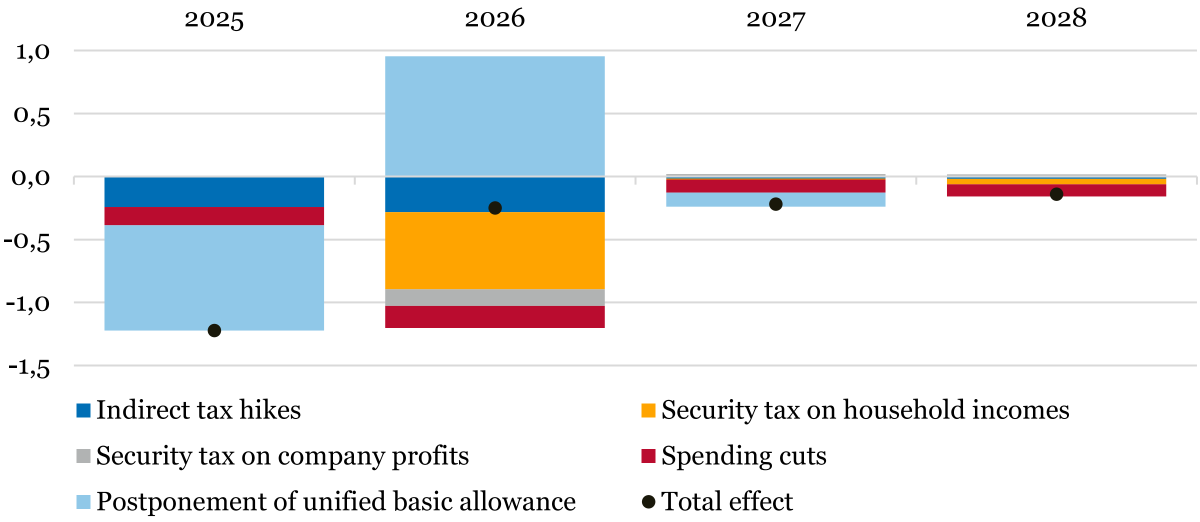
Increases in consumption taxes reduce the real volume of the economy through the decline in household purchasing power. Since price growth will accelerate, the impact on the nominal volume of the economy is smaller than on the real volume. Consumer price increases will accelerate due to the rise in VAT and excise duties by 0.8 percentage points next year and by 1

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

https://eelarvenoukogu.ee/news/the-summer-forecast-finds-there-is-not-room-in-the-budget-for-increasing-spending percentage point in 2026.

Figure 2

The impact of budgetary measures on real GDP growth in relation to no-policy-change forecast (percentage points)



Source: Ministry of Finance.

The above estimates of the impact on GDP are based on the broader economic impact of the measures, i.e., both direct, indirect, and induced effects are taken into account. To assess the broader economic impact of the measures, a macroeconomic model based on input-output frameworks was used, with some results adjusted by the experts of the Ministry of Finance. The impact of measures on domestic added value is smaller than the total volume of the measures, as they also include imports.

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In the following, Ministry of Finance's 2024 summer forecast is compared with the latest public macroeconomic forecasts by other institutions. When comparing them, one should keep in mind that forecasts are compiled in different periods and are therefore based on different information, which causes variations in assumptions and results of the forecasts.

The forecasts published by other institutions after the Ministry of Finance's summer forecast have been similar in terms of key positions and the overall narrative. A modest economic decline is expected for 2024. The consensus inflation forecast remains slightly below 4%. For 2025, there is somewhat greater divergence in growth forecasts, ranging from 1% to 2.5%. The differences originate from varying assumptions about when the economy will return to growth, which largely depends on the growth outlook of export partners, as well as estimates of the impact of the fiscal consolidation measures on the economy.

The Ministry of Finance's real economic growth forecast for 2025 falls in the middle of this forecast range. However, compared to the Bank of Estonia's forecast, the expected fiscal outcomes are quite similar. The latest available economic data suggests that the decline is continuing to ease, and the second half of the year will bring a gradual improvement in economic conditions. Company revenues have started to grow year-over-year, and there is also slight growth visible in some export sectors.

Table 1.f. Comparison of economic forecasts

	Real GDP growth, %			CPI growth, %		
	2024*	**2025***	**2026***	**2024***	**2025***	**2026***
Ministry of Finance	**-1,0**	**2,1**	**2,7**	**3,8**	**5,0**	**3,2**
Bank of Estonia	-0,4	1,9	3,0	3,5	3,9	3,6
Swedbank	-0,6	1,5	2,5	3,7	4,4	3,5
SEB	-0,7	2,5	2,7	3,8	3,5	3,0
Luminor	-1,0	1,0	1,0	4,0	5,0	4,0

Sources:
Ministry of Finance. 2023 summer forecast. 27.08.2024
Eesti Pank, Rahapoliitika ja majandus. 3/2024. 24.09.2024.
Swedbank. Swedbank Economic Outlook – August 2024. 27.08.2024.
SEB. Nordic Outlook. August 2024. 27.08.2024.
Luminor. Luminori prognoos. 18.09.2024.

2. Budgetary targets

The primary goal of the government's fiscal policy during the current budget strategy period is to continue reduction of the budget deficit, which has deepened due to the COVID-19 crisis and continues to be affected by Russia's unjust war of aggression in Ukraine. To move towards balancing the general government budget, it is necessary to explore cost-saving opportunities, and to identify permanent sources of financing to cover increased expenditure needs. **In the long term, the primary objective of the government's fiscal policy is to support macroeconomic stability by promoting market flexibility and efficiency, as well as to manage risks that threaten the balanced development of the economy.**

As a result of the global pandemic and Russia's war of aggression in Ukraine, the economy continues to face a challenging situation. Due to a weak external environment and the changed geopolitical landscape, actual economic growth in the coming years will remain significantly below its potential level. The application of the General Escape Clause of the Stability and Growth Pact for recent years has allowed the deficit and debt levels to increase. The government has affirmed a strong commitment to avoiding excessive budget deficits, meaning that the nominal budget deficit must not exceed 3% of GDP, while also taking into account the increased need for additional security-related expenditures.

In the current state budget strategy, the Government decided to reduce the nominal budget deficit for each year, keeping the deficit consistently below 3% of GDP. Although the structural deficit will increase in the coming years, it is expected to decrease to 1.4% of GDP by 2028. Compared to the previous state budget strategy, the deficit in 2025 will be 1.1% of GDP higher, and in 2026 and 2027, it will be 1.3% higher.

In 2023, the general government debt did increase by 1 percentage points and reached 20% of GDP, amounting to EUR 7 643 million. The debt increased due to the increase in the debt level of the central government but also of the local governments. This year, the debt burden of the general government is expected to increase to 23,7% of GDP. This is due to a faster nominal increase in the debt level combined with slower nominal growth of GDP. **The general government debt increases to 25% of GDP by the end of 2025.**

The opinion of the Fiscal Council on the structural budget position objectives for 2025-2028

Pursuant to §14 of the State Budget Act, the Fiscal Council issued an opinion on the objectives of the structural budget position for 2025-2028 on 25 September.[2] The government's intention is to keep the nominal budget deficit close to 3% of GDP in the coming years. However, further reduction of the deficit has been delayed compared to previous plans.

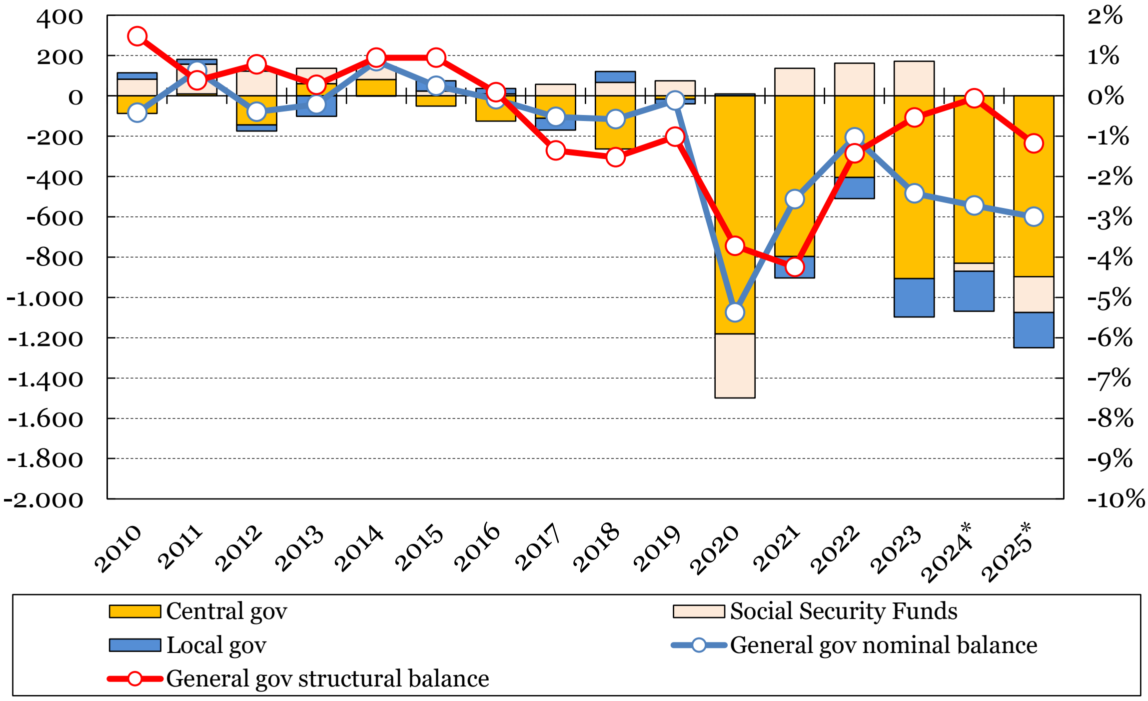
The Fiscal Council noted that the Ministry of Finance forecasts the structural deficit for 2025 in line with domestic fiscal rules. On the other hand, planned budget trajectory for 2026-28 does not comply with the fiscal rules of the State Budget Act, by which structural deficit must be kept below 1% of GDP. To comply with this requirement, the fiscal position for the years 2026-28 should be improved by approximately one billion euros.

[2] https://eelarvenoukogu.ee/uudised/valitsuse-kavandatav-eelarveparandus-ei-vasta-kodumaistele-eelarvereeglitele

Figure 3

General government budgetary position

(% of GDP)



Source: Statistics Estonia, Ministry of Finance.

To ensure compliance with the EU fiscal rules, Member States are required to ensure that the growth of net nationally financed primary expenditures does not exceed the fiscal trajectory set by the Fiscal Structural Plan. Estonia's actual net expenditure path has been calculated by the Ministry of Finance, based on the state budget strategy for 2025-2028, prepared in September 2024. According to these calculations, the expected growth of the net nationally financed primary expenditure in 2025 is 1.3% (see Table 2), taking into account the discretionary revenue measures included in the State Budget Strategy. The growth of net expenditures in the State Budget Strategy remains below the path set by the Fiscal Structural Plan, expenditure growth is curtailed by the 3% of GDP deficit limit.

Table 2 Single operational reference for fiscal surveillance

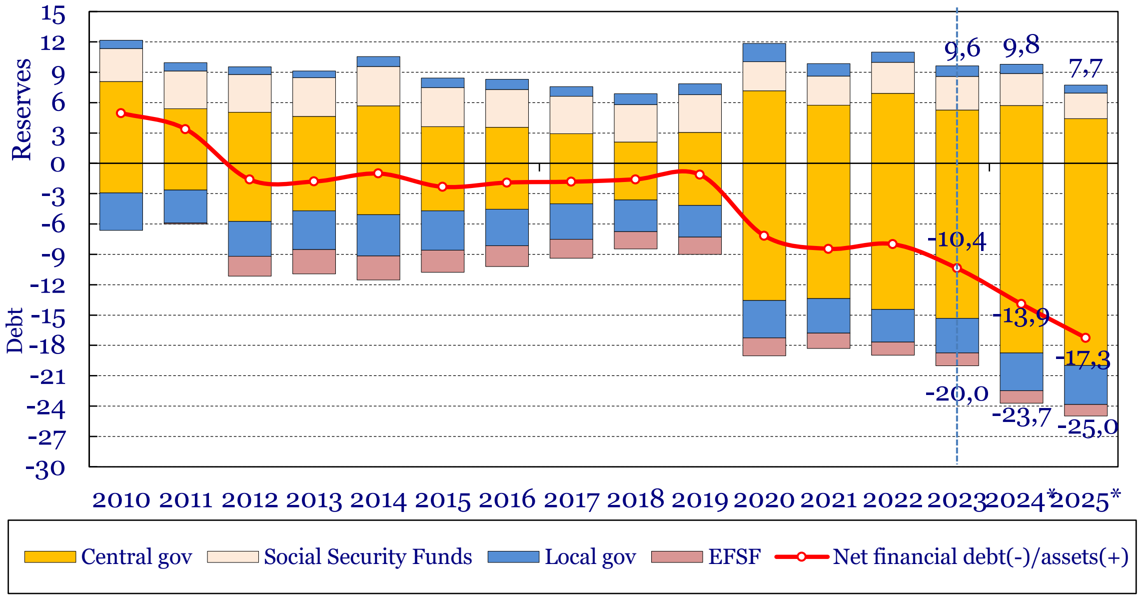
	Council recommendation		Outturn/projection	
	2024	2025	2024	2025
	growth rate	growth rate	growth rate	growth rate
Net nationally financed primary expenditure	1.9	7.1	2.0	1.3

Source: Ministry of Finance.

Figure 4

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

(% of GDP)

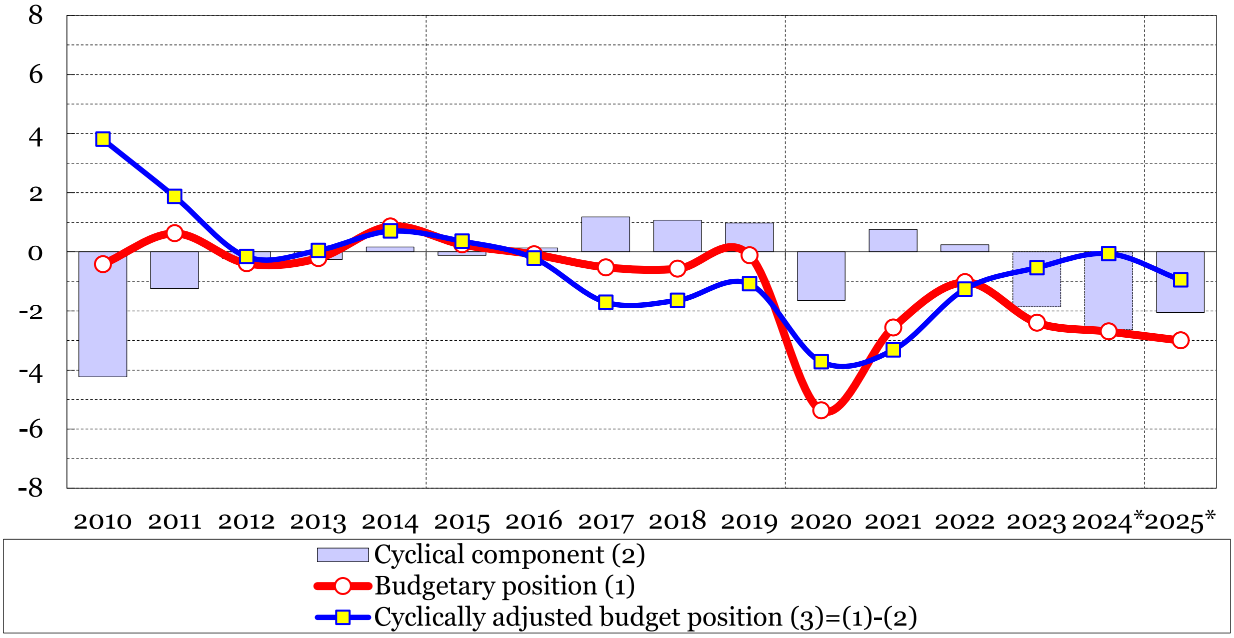


Source: According to Statistics Estonia revised 2001-2023 data on 23.09.2024, Ministry of Finance.

Figure 5

General government cyclically adjusted budgetary position

(% of GDP)

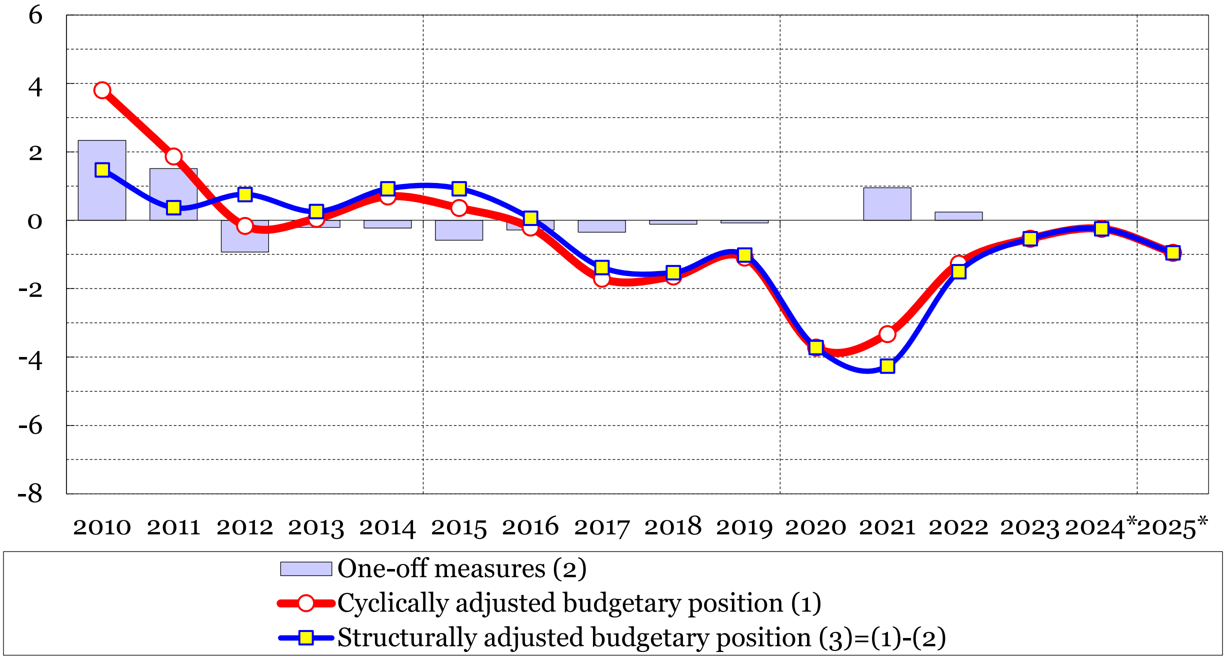


Source: Statistics Estonia, Ministry of Finance.

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	2024 (1/) % GDP	2025* % GDP
Net lending (+) / net borrowing (-) (B.9) by sub-sector			
1. General government	S.13	-2.7	-3.0
2. Central government	S.1311	-2.1	-2.2
3. State government	S.1312	-	-
4. Local government	S.1313	-0.5	-0.4
5. Social security funds	S.1314	-0.1	-0.4
6. Interest expenditure	D.41	0.5	0.6
7. Primary balance (3/)		-2.3	-2.4
8. One-off and other temporary measures (4/)		0.0	0.0
9. Real GDP growth (%) (=1. in Table 1a)		-1.0	2.1
10. Potential GDP growth (%) (=2 in Table 1.a)		0.2	0.8
contributions:			
- labour		0.6	0.5
- capital		1.4	1.4
- total factor productivity		-1.8	-1.2
11. Output gap (% of potential GDP)		-5.5	-4.2
12. Cyclical budgetary component (% of potential GDP)		-2.7	-2.1
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		-0.1	-0.9
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		0.4	-0.4

15. Structural balance (13 - 8) (% of potential GDP)		-0.1	-0.9

1/ According to Draft 2025 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	**2024***	**2025***
		% of GDP	*% of GDP*
1. Gross debt		23,7	25,0
2. Change in gross debt ratio		3,7	1,3
Contributions to changes in gross debt			
3. Primary balance		-2,3	-2,3
4. Interest expenditure (3/)	D.41	0,5	0,7
5. Stock-flow adjustment		1,5	-0,3
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/)		2,4	3,3
Other relevant variables			
6. Liquid financial assets (2/)		9,8	7,7
7. Net financial debt (7=1-6)		13,9	17,3
8. Debt amortization (existing bonds) since the end of the previous year [3]		1,8	3,2
9. Percentage of debt denominated in foreign currency		0	0
10. Average maturity [4]		6,0	6,0

1/ Proxied by interest expenditure divided by the debt level of the previous year.
2/ Liquid assets are here based on the accounting methodology which corresponds to the Consolidated Annual Report of the State. The definition of liquid financial assets covers the use of accounting standards, involving only those assets which are realizable in the short-term (including cash and deposits, debt securities, short-term trading quoted shares and investment fund shares)
3/ The forecast 2025 does not include financial intermediation services indirectly measured (FISIM)

Source: Ministry of Finance.

Table 2.c. Contingent liabilities

	2024*	**2025***
	% of GDP	*% of GDP*
Public guarantees	7.4	7.0
Of which: linked to the financial sector	7.3	6.9

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

Table 3 presents general government revenues and expenditures in terms of main categories according to no-policy change scenario.

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

General Government (S.13)	ESA Code	2024*	2025*
		% of GDP	*% of GDP*
1. Total revenue at unchanged policies	TR	42.1	40.3
of which			
1.1. Taxes on production and imports	D.2	13.9	14.0
1.2. Current taxes on income, wealth, etc.	D.5	8.8	7.9
1.3. Capital taxes	D.91	0	0
1.4. Social contributions	D.61	12.6	12.5
1.5. Property income	D.4	1.1	0.5
1.6. Other		5.6	5.3
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		35.2	34.3
2. Total expenditure at unchanged policies	TE	45.0	44.8
of which			
2.1. Compensation of employees	D.1	11.9	11.7
2.2. Intermediate consumption	P.2	7.0	6.4
2.3. Social payments	D.62 D.632	15.4	15.5
of which Unemployment benefits		0.7	0.7
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0.5	0.6
2.5. Subsidies	D.3	0.6	0.6
2.6. Gross fixes capital formation	P.51	6.8	7.3
2.7. Capital transfers	D.9	0.8	0.7
2.8. Other		2.0	2.0

Source: Ministry of Finance.

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

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

General Government (S.13)	ESA code	2024*	2025*
		% of GDP	*% of GDP*
1. Total revenue target	TR	42.0	41.9
of which			
1.1. Taxes on production and imports	D.2	13.9	14.3
1.2. Current taxes on income, wealth, etc	D.5	8.8	9.1
1.3. Capital taxes	D.91	0	0
1.4. Social contributions	D.61	12.6	12.5
1.5. Property income	D.4	1.1	0.6
1.6. Other		5.6	5.3
p.m.: Tax burden (=D.2+D.5+D.61+D.91-D.995)		35.1	35.8
2. Total expenditure target	TE	44.8	44.9
of which			
2.1. Compensation of employees	D.1	11.9	11.7
2.2. Intermediate consumption	P.2	7.0	6.5
2.3. Social payments	D.62 D.632	15.4	15.4
of which Unemployment benefits		0.7	0.7
2.4. Interest expenditure (=9. in Table 2.a)	D.41	0.5	0.6
2.5. Subsidies	D.3	0.6	0.6
2.6. Gross fixes capital formation	P.51	6.7	7.4
2.7. Capital transfers	D.9	0.8	0.7
2.8. Other		2.0	2.0

Source: Ministry of Finance.

Table 4.c i) and 4.c ii) present government expenditures by function. The expenditure measures have an impact on almost all functions of the government sector. In 2025 state

budget strategy measures increased mostly defence spending while reducing expenditures on healthcare and education.

Table 4.c. General government expenditures by function

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

	2024*		2025*	
	% of GDP	*% of general government expenditure*	*% of GDP*	*% of general government expenditure*
Education	6.4	14.3	6.3	14.1
Healthcare	7.0	15.5	7.0	15.5
Employment	0.2	0.5	0.2	0.5

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

Functions of the Government	**COFOG code**	**2024***	**2025***
		% of GDP	*% of GDP*
1. General public services	1	4.7	4.7
2. Defence	2	3.7	3.5
3. Public order and safety	3	1.8	1.8
4. Economic affairs	4	4.4	4.7
5. Environmental protection	5	0.5	0.5
6. Housing and community amenities	6	0.4	0.4
7. Health	7	7.0	7.0
8. Recreation, culture and religion	8	1.9	1.7
9. Education	9	6.4	6.3
10. Social protection	10	14.2	14.2
11. Total expenditure (=2. in Table 4.a)	**TE**	**44.8**	**44.9**

Source: Ministry of Finance.

5. Description of discretionary measures included in the draft budget

Discretionary measures that have an impact on state budget revenue and expenditure in 2025, are presented in table 5.a.

The 2025 budget includes several revenue measures to improve the budget position, with the most significant impact coming from car tax, the increase of the VAT to 24% and the increase of the corporate and personal income tax rate. The measures that are expected to also have impact at least 0.1% of GDP on budget revenues are related to changes to dividends, the timing of dividends, increase in the advance income tax rate for credit institutions and environmental fees. The planned discretionary measures include a significant increase in tax revenue to cover the rising defence costs. As part of the introduction of a broad-based security tax that is starting from July 2025, the VAT will be increased by two percentage points to 24%. The security tax will be implemented temporarily until the end of 2028. Starting from January 2025, the income tax for both individuals and corporate entities will be increased by 2%, from 20% to 22%. Additionally, it is planned to further raise the excise duty rates on alcohol and tobacco by 5% annually, in addition to the already established excise increases, and a 5% annual increase in excise duties is also planned for gasoline. Tax revenue will also be increased by income from the sale of assets and the major investor support measure, where at the maximum support rate of 15%, the paid support and the additional tax revenues collected by the state are balanced.

The expenditures will be reduced by cost-saving measures planned by the state budgetary institutions, cuts in operating expenses and research and development costs across areas of governance, postponement of investments. In addition to cost-saving measures, the 2025 budget also includes additional resources for national defence and ensuring broader security.

Table 5.a. Discretionary measures taken by General Government

	Title/description measure	One-off	Exp / Rev	Sub-sector		2025
					ESA Code	% GDP
1	Amendments to the Income Tax Act	No	Revenue	S 13 General Government	D5	0,72%
2	Increase of the VAT to 24% as a part of a security tax	No	Revenue	S 13 General Government	D5	0,27%
3	Increase in excise duty rates and gambling tax rates	No	Revenue	S 13 General Government	D2	0,14%
4	Changes in environmental fees	No	Revenue	S 13 General Government	D2	0,16%
5	Other income measures	No	Revenue	S 13 General Government	D4, Other	0,11%
6	Introduction of the car tax	No	Revenue	S 13 General Government	D2, D61, D4, D5, Other income	0,57%
7	New and postponed Investments	No	Expenditure	S 1311 Central Government	P51	0,13%
8	Additional defence expenditures	No	Expenditure	S 1311 Central Government	D1, P2, P51	0,24%
9	Other expenses (shifting of expenditures between years, IT expenses, additional revision of expenses)	No	Expenditure	S 1311 Central Government	D1, D62, D7, P2, P51	0,19%
10	Changes in the government reserve	No	Expenditure	S 1311 Central Government	D1, P2, D7	0,02%
11	Additional revision of expenses	No	Expenditure	S 1314 Social security funds	D63	-0,05%
12	Reduction in labor, research and development expenditures and administrative expenses of the state budgetary institutions; Reduction in expenditures of state-owned companies	No	Expenditure	S 1311 Central Government	D1, P2, P51	0,07%

Source: Ministry of Finance.

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

In this chapter information is presented on how the measures in the draft budget plan take into account the country-specific recommendations (CSRs).[5]

Table 6.a. Country-specific recommendations

CSR no	List of measures	Description of direct relevance
1.	Submit the medium-term fiscal-structural plan in a timely manner. In line with the requirements of the reformed Stability and Growth Pact, limit the growth in net expenditure16 in 2025 to a rate consistent with reducing the general government deficit below the 3% of GDP Treaty reference value and keeping the general 16 According to Article 2(2) of Regulation (EU) 2024/1263, 'net expenditure' means government expenditure net of interest expenditure, discretionary revenue measures, expenditure on programmes of the Union fully matched by revenue from Union funds, national expenditure on co-financing of programmes funded by the Union, cyclical elements of unemployment benefit expenditure, and one-offs and other temporary measures. EN 10 EN government debt at a prudent level over the medium term. Broaden the tax base and improve access to and financing of healthcare and long-term care.	The first medium-term fiscal-structural plan has been approved by the Estonian Government on 11. October 2024 and submitted to European Commission. The Government has set a goal to ensure prudent fiscal policy and has already made decisions of cost savings and tax rises in 2024 and 2025. In 2025, structural balance is planned to be on the level of 0.9% of GDP, which means the nominal deficit will remain at the level of 3,0% of GDP. Debt burden stays on low level of 24.3 % of GDP. Increase of nationally financed net nationally financed primary expenditure according to our own initial calculations is at 1.7% in 2025. **Implementation of the budget review (2023-2027)** The state budget review plan was approved at a meeting of the Cabinet of Ministers on 31 August 2023. The areas of government of all ministries will be analysed by 2027. The aim of the review is the efficient use of state budget resources and the provision of relevant services and activities at optimal costs in accordance with the state's objectives. **A set of tax amendments** (imposition of motor vehicle tax, amendments to the Income Tax Act and amendment of excise duty rates; the introduction of a time-limited security tax). The state budget strategy 2025-2028 provides for the establishment of a wide-ranging security tax - starting from July 2025, the value added tax will be increased by two percentage points to 24 per cent, from 2026, the taxation of all income of natural persons will be added by two per cent, and the taxation of corporate profits by two per cent. The security tax will be introduced on a temporary basis until the end of 2028. In addition, it is planned to increase the excise duty rates of alcohol and tobacco by an additional 5% per year in addition to the excise duty increases already established, and excise duty increases of 5% per year are also intended for petrol excise duty.
2.	Continue with the swift and effective implementation of the recovery and resilience plan, including the REPowerEU chapter, ensuring	1. Just green and digital transitions, including alignment with the European Climate Law **Implementation of the recovery and resilience plan.**

[5] Recommendation for a COUNCIL RECOMMENDATION on the economic, social, employment, structural and budgetary policies of Estonia - Publications Office of the EU (europa.eu)

	completion of reforms and investments by August 2026. Accelerate the implementation of the cohesion policy programme. In the context of the mid-term review, continue focusing on the agreed priorities, taking action to better address the needs in the long-term care sector, while considering the opportunities provided by the Strategic Technologies for Europe Platform initiative to improve competitiveness.	2. Social and economic resilience, including the European Pillar of Social Rights **Implementation of the recovery and resilience plan.** 3. Energy security **Implementation of the recovery and resilience plan.** 4. Social and economic resilience, including the European Pillar of Social Rights **Improving the quality and accessibility of special care**. In order to improve the quality and availability of special care, it is necessary to ensure the sustainable financing of services, reduce the queues of service places and increase the focus on the development of community-based services. With the support of European Union and state budget funds, 14 institutions with 1,725 service places have been reorganised by 2024 and 514 new community living service places have been created. In order to complete the reorganisation after 2027, 5 additional special care providers (a total of 390 service places to be reorganised) will need to be reorganised to ensure that people with mental disorders will be able to live in conditions that meet modern requirements. In order to improve the quality and availability of special care, it is necessary to ensure the sustainable financing of services, reduce the queues of service places and increase the focus on the development of community-based services. With the support of European Union and state budget funds, 14 institutions with 1,725 service places have been reorganised by 2024 and 514 new community living service places have been created. In order to complete the reorganisation after 2027, 5 additional special care providers (a total of 390 service places to be reorganised) will need to be reorganised to ensure that people with mental disorders will be able to live in conditions that meet modern requirements. **Reorganization of the Rehabilitation System.** In order to ensure that people in need of rehabilitation receive services according to their needs, that reaching the services is easy and supported for the person and that the services are provided in an integrated manner in cooperation between several fields (social, health, work and education), the rehabilitation system will be reorganised. The changes that have been made so far have improved the situation, but people's need for comprehensive assistance across sectors (in addition to social security, health care, education, employment, etc.) must be looked at more than before. In addition to changes in the organisation of services, there is a need to continuously develop the entire rehabilitation and rehabilitation system in such a way that it allows people's abilities to be maximised with the support of services that are tailored to their needs, timely, smoothly functioning and accessible. **Social and health integration.** As part of the comprehensive development of health care management in Estonia, the model of health care management will be updated, including the provision of integrated people-centred services in the social and health care spheres in cooperation with local governments and the development of event-based services. Among other things, the priority for 2024-2025 will be to ensure sustainable financing of health care and access to health care by improving the efficiency of the health system, training the offspring and other relevant measures. Developmental

		trends in the health system will be compiled and implemented. Health services and social services will be integrated and coordinated delivery will be improved, including analysis of organisational and financing models, implementation of common case management principles, introduction of prevention activities, introduction of modern information technology solutions and improvement of data exchange. Reducing health inequalities is also a priority. The launch of a centre of excellence in cancer prevention, diagnosis, treatment and research will also be a priority. **Pursue the reform of long-term care and improve the quality and accessibility of special care.** The implementation of the care reform will continue, including solving practical problems, the aim of which is to reduce the payment burden of people in need of round-the-clock general care service and their loved ones in financing the service and the care burden of their loved ones, to improve the quality of the service and the wages and working conditions of care workers, and to improve the availability of services supporting living at home. The financing of special care services needs to increase significantly, service places (especially those supporting living at home, but there is also a need for 24/7 places) need to be created, and it is necessary to prepare and finance the implementation of a person-centred service model. The organisation and financing of the 24-hour special care nursing service will be transferred to the Health Insurance Fund as of 2025. In addition, the focus is on supporting activities based on innovative solutions.
3.	Strengthen social protection, inter alia to address old-age poverty and by extending the coverage of unemployment benefits, in particular to those with short work spells and in non-standard forms of work.	**Reform of unemployment allowance and unemployment insurance and extension of unemployment insurance coverage to new forms of work.** The amendments will organise the unemployment benefit system. By reorganising unemployment benefits, the conditions for unemployment benefits are harmonised, ensuring that unemployment benefits are more targeted, effective and available in sufficient quantities. The Ministry of Economic Affairs and Communications is analysing the possibilities of extending unemployment insurance cover to new forms of work.
4.	Reduce the share of oil shale in the energy mix and raise resource productivity through bio-based innovation. Improve labour productivity and skills supply through reskilling and upskilling, and by better attracting and retaining talent.	**Renewable electricity 100 reform (renewable energy transition by 2023)** The main task of the green reform is to achieve a balanced transformation of society and the economy by reducing the negative impact of human activities on the environment, strengthening the competitiveness of businesses and thereby providing people with a high-quality and clean living environment. In the current security crisis, accelerating green reform will help increase the resilience and adaptability of societies and reduce vulnerabilities to external factors. In the context of the green transition, renewable energy is competitive. The state has set a target for the share of renewable energy, and the current progress towards this target is hopeful. The share of renewable energy in final energy consumption was 38% in 2022. This figure is improving (31.7% in 2019), but the Estonia 2035 strategy sets a target of at least 65%. **The adoption of the Climate-Resilient Economy Act.** In September 2023 started the process of drafting the Climate-Resilient Economy Act in Estonia. The law will create the basis for a climate-proof economy by setting targets for greenhouse

		gas emissions, encouraging the adoption of clean technologies and increasing the valorisation of resources. This will reduce the negative impact on the environment and climate and improve people's living environment. By encouraging clean technologies and developing the infrastructure that supports them, the competitiveness of enterprises will increase, including the reduction of long-term fixed costs for both people and businesses through increased energy efficiency and the introduction of renewable energy sources on the market. In addition, new industries and competitive industries are emerging. **Reform of vocational education**. As part of the reform, new broad sectoral vocational secondary education curricula will be developed, strengthening general education studies and the learning of general competences. New principles of financing vocational education institutions will also be developed, including a regulation of paid vocational education to restrict recurrent studies. Work will begin on a new Vocational Education Act, in line with the proposed reform of the Uniform Secondary Education Act and the vocation system, which would replace the current Vocational Educational Institutions Act. **We will create a talent-friendly environment, supporting talented learners through the development of a comprehensive system of integrated formal education and non-formal learning in cooperation with local governments.** Encouraging the learning of science, technology and creative disciplines and ensuring the next generation of teachers for their teaching in all age groups and types of education (including non-formal learning).

Annex

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

Revenue from RRF grants (% of GDP)							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
RRF GRANTS as included in the revenue projections		0,006	0,088	0,321	0,796	0,612	0,372
Cash disbursements of RRF GRANTS from EU		0,401	0	0,672	0,315	0,593	0,457

Expenditure financed by RRF grants (% of GDP)							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
TOTAL CURRENT EXPENDITURE		0,004	0,017	0,033	0,109	0,112	0,041
Gross fixed capital formation P.51g		0	0,025	0,044	0,265	0,163	0,044
Capital transfers D.9		0,002	0,046	0,244	0,423	0,337	0,287
TOTAL CAPITAL EXPENDITURE		0,002	0,072	0,288	0,688	0,5	0,331

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

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

Table 10. Net expenditure growth

	ESA Code	2023 (level)	2023 (% of GDP)	2024 (% of GDP)	2025 (% of GDP)
1. Total expenditure	TE	16,5	43,2	44,8	44,9
2. Interest expenditure	D.41p	0,1	0,4	0,5	0,6
3. Cyclical unemployment expenditure		0,0	0,0	0,1	0,2
4. Expenditure funded by transfers from the EU		0,5	1,4	1,8	1,7
4a. Of which: Investments (GFCF)		0,2	0,6	0,5	0,5
5. National co-financing of EU programmes		0,1	0,2	0,2	0,3
6. One-off expenditure (levels, excl. EU funded)		0,0	0,0	0,0	0,0
7. Net nationally financed primary expenditure (before DRM) (ne = 1-2-3-4-5-6)		15,7	41,2	42,1	42,2
8. DRM (excl. one-off revenue, incremental impact)		-	-	1,2	2,0
9. Net nationally financed primary expenditure (after DRM) (ne - drm = 7 - 8)		-	-	40,9	40,2
				2024 (rate of change)	2025 (rate of change)
10. Nominal GDP growth (g) (growth rate)		-	-	2,7	6,2
11. Net expenditure growth (growth rate) $= \frac{ne_t - drm_t}{ne_{t-1}} * (1 + g_t) - 1$		-	-	2,0	1,3